In the Supreme Court of the United States

OCTOBER TERM 1952

THE WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I. DUP. BAYARD, Receiver,
Petitioners,
vs.
THE WESTERN PACIFIC RAILROAD COMPANY, et al.,
Respondents.

No. 150

MEREDITH H. METZGER, HENRY OFFERMAN and J. S. FARLEE & CO., INC.,
Petitioners,
vs.
THE WESTERN PACIFIC RAILROAD COMPANY, et al.,
Respondents.

No. 160

On Writs of Certiorari to the United States Court of Appeals for the Ninth Circuit

Supplement to Brief for Respondents

Opinions of the Courts Below

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Assembled and reprinted for convenience of Court and counsel

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1. Opinion of September 6, 1949, in the United States District Court, Northern District of California, Southern Division.

[258*]

[Title of District Court and Cause.]

OPINION

Goodman, District Judge.

Plaintiff, a former holding company, whose interest in its subsidiary had been finally declared valueless in the subsidiary's reorganization proceeding under § 77 of the Bankruptcy Act, has tendered the novel claim that it should be awarded, in equity, a part, if not all, of the subsidiary's income tax saving while in reorganization, resulting from the filing of consolidated corporate income tax returns.

A somewhat detailed history must be set down [259] in order to properly appraise the unique demand of plaintiff.

Plaintiff is The Western Pacific Railroad Corporation; its subsidiary was Western Pacific Railroad Company, an operating railroad company, herein referred to as the "debtor"; defendant, the reorganized subsidiary, is The Western Pacific Railroad Company.

Statement of Facts

Plaintiff corporation, a so-called holding company, from 1916 to April 30, 1944, owned all the outstanding capital stock of the debtor. For some years prior to 1935, the financial condition of the debtor had been steadily worsening. In 1935 it filed a petition under Section 77 of the Bankruptcy Act (11 USC 205) and this Court in that year

*Figures in brackets refer to pages of Record.

placed its affairs in the hands of trustees. Thereafter a plan of reorganization was proposed and in 1939 it was approved by the Interstate Commerce Commission. 233 ICC 409. Inter alia, it was determined in the plan that the capital stock of the debtor owned by the plaintiff was without equity or value and that plaintiff and its stockholders therefore were not entitled to participate in the plan. In 1940 this Court approved the plan of reorganization, including approval of the findings of the Interstate Commerce Commission as to the worthlessness of the plaintiff's equity. The Circuit Court of Appeals (now Court of Appeals) of the Ninth Circuit reversed in 1941 (124 F. 2d 136). In 1943 the Supreme [260] Court reversed the Circuit Court and affirmed the order of the District Court. (318 U.S. 448). It there considered and rejected the contention of the plaintiff that it should have the right to participate in the plan because of recent increased earnings of the debtor. (318 U.S. 508, 509.) [1]Thereafter, the plan of reorganization was, in accordance with the statutory provisions (11 USC 205e), submitted to the creditors, and, after their approval, the plan was confirmed on October 11, 1943, by this Court. The reorganization committee designated in the plan of reorganization, instead of forming a new corporation, determined to use the corporate structure or shell of the old company (debtor) and to execute the plan of reorganization by revesting its former properties in the reorganized company, i.e., the defendant. On November 22, 1943, an agreement was made between the plaintiff, its secured creditors and the reorganization com-

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[1]See in re Denver & R.G.W.R. Co. 10 Cir. 150 Fed. 2d 28 and R.F.C. v. D. & R.G.R. Co. 328 U.S. 495, where similar holdings upon similar contentions were made.

mittee wherein a modus of revesting was set up. Among other things, the plaintiff agreed therein to transfer all of its stock in the debtor to the reorganization committee. This agreement was approved by this Court, in December, 1943. The transfer of the stock was not actually made until April, 1944, because of an unsuccessful litigative[2] attempt [261] to prevent the same. During the period of years in which the plaintiff was the owner of all the outstanding stock of the debtor, plaintiff had followed the practice of filing consolidated or affiliated income tax returns, in which it had reported the earnings of the debtor as well as other affiliated companies, which the plaintiff wholly or partly owned. The amount of taxes paid by the plaintiff pursuant to such returns was allocated among the various subsidiary companies having taxable income in proportion to the amount of such taxable income. The practice of filing the consolidated returns continued throughout the reorganization period. The returns, during the reorganization period, were prepared by the employees of the debtor and signed by the president of the plaintiff corporation, although they were never submitted to its board of directors for approval or consideration.

During the year 1942, the debtor made substantial net earnings. Neither plaintiff, nor any of its other subsidiary companies, had any earnings during 1942. A consolidated return was filed for the year 1942 in which the tax liability, due to the earnings of the debtor, was $4,144,828. Later in 1943, after the filing of the 1942 return and payment of the tax, the tax attorneys for defendant "discovered" Section

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[2]Bryant v. Western Pac. R. Corp. 35 A. 2d 909 (Del. Ch. Feb. 10, 1944.)

123 of the Revenue Act of 1942. (26 USC 23(g)4.)[3] They proposed what they de- [262] noted a "paradoxical" theory, by which the worthlessness of the plaintiff's stock (which had cost the plaintiff some $75,000,000) in the operating railroad company (debtor), might be availed of as an offset to the operating income of the debtor and thus result in a net loss and no tax obligation. Further, their theory was that part of this $75,000,000 loss in 1943, could be "carried back" to 1942 (§ 122(b)(1) of the Internal Revenue Code.) and part could be "carried over" to 1944 (§ 122(b)(2) of the Internal Revenue Code.).

Thereupon a claim for refund of the amount of tax paid for 1942 was filed in the name of the plaintiff. Operations of the debtor during 1943 and up to April 30, 1944, were increasingly profitable and, except for the offset of the capital stock loss of the plaintiff itself, would have called for the payment of some $17,000,000 in income taxes. So the tax attorneys caused the filing of consolidated tax returns for 1943 and for the forepart of 1944 in the name of plaintiff, in which sufficient portions of the $75,000,000 stock loss were used as offsets against the operating accounts for these years, so as to show no net income. The validity of the offsets was questioned by the Commissioner of Internal Revenue and conferences were had between the tax counsel for the defendant and the Commissioner. As a result, a tax settlement was made with the Commissioner [263] whereby, in consideration of the withdrawal of the claim for refund,

[3] "Stock in affiliated corporation. For the purposes of paragraph (2) stock in a corporation affiliated with the taxpayer shall not be deemed a capital asset." (Subsection 4 of § 23g). By this subsection, losses resulting from worthlessness of stock of an affiliate became operating losses instead of capital losses as theretofore.

the Commissioner accepted and approved the returns. The nature and basis of this compromise settlement will be hereafter more fully discussed.

Subsequent to the filing of the claim for refund of the 1942 tax paid, and the filing of the consolidated tax returns for 1943 and part of 1944, and after negotiations for the settlement of the entire tax issue with the Commissioner of Internal Revenue had started, the plaintiff, on October 10, 1946, filed its bill of complaint in equity herein. In substance the bill of complaint recited the filing of the claim for refund, the commencement of the negotiations for the approval of the consolidated returns and prayed that the Court settle the proprietary rights of the plaintiff and the defendant in the tax saving involved. It was further prayed that funds equivalent to the tax savings be placed in the custody of the court for proper and equitable distribution.[4]

On April 7, 1947, the Court permitted the filing of a complaint in intervention on behalf of certain stockholders of the plaintiff who wished to join in the demand of the plaintiff and in its prayer for relief against the defendant. The settlement and agreement with the Commissioner, by which the claim for refund was withdrawn and the consoli- [264] dated returns for the years 1942, 1943 and part of 1944 were accepted and approved, was consummated on August 14, 1947.

On December 17, 1947, plaintiff filed a supplementary bill of complaint, wherein the consummation of the settlement and compromise was set forth. It was there further

[4] The debtor had on two separate occasions set aside reserve funds for the payment of the taxes, to protect against the contingency of adverse ruling by Commissioner or Court.

October 26, 1936—

A. C. James Co. plan of reorganization filed.

(This plan recommended the use of the corporate charter of the Debtor in effecting reorganization.)

June 21, 1939—

Order entered by Interstate Commerce Commission approving modified plan of reorganization and finding, *inter alia*, that (1) the unsecured claims of the Holding Corp against the Debtor are "without value" and that (2) the capital stock of the Debtor (owned by the Holding Corp) is "without equity or value, and the stockholders shall not be entitled to participate in the plan."

The order provides that "The plan may be carried out either by revesting the properties formerly of the debtor in the debtor company or by transferring said properties to a new corporation organized for the purpose * * *"

The order recites that "The effective date of said plan shall be January 1, 1939." (233 I.C.C. 409)

September 19, 1939—

Order entered by Interstate Commerce Commission denying the petition of the Holding Corp for modification of the plan of reorganization.

August 15, 1940—

Order entered by Reorganization Court approving the Interstate Commerce Commission's plan of reorganization. (34 F. Supp. 493)

November 28, 1941—

Decision of Circuit Court of Appeals reversing order of Reorganization Court. (124 F.2d 136)

April 27, 1942—

Certiorari granted by Supreme Court of United States.

March 15, 1943—

Decision of Supreme Court of United States, on writ of certiorari, reversing Circuit Court of Appeals and affirming order of Reorganization Court approving plan of reorganization. (318 U.S. 448)

October 11, 1943—

Order entered by Reorganization Court confirming plan of reorganization and approving designation of Reorganization Committee.

November 22, 1943—

Agreement executed between Holding Corp, its secured creditors and Reorganization Committee providing *inter alia* for the transfer of the preferred and common stock of the Debtor to the Reorganization Committee.

December 17, 1943—

March 15, 1943—

Tentative consolidated incom
filed by Holding Corp in beh

May 15, 1943—

Final consolidated income an
filed by the Holding Corp in

NOTE: The taxes were paid in qu
the following amounts, respectively:

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*The practice of filing consolidate
1918 and was continued thereafter

March 15, 1943—

Tentative consolidated income and excess profits tax returns for calendar year 1942, showing tax liability of $4,209,948, filed by Holding Corp in behalf of all members of affiliated group.

May 15, 1943—

Final consolidated income and excess profits tax returns for calendar year 1942, showing tax liability of $4,201,821.54, filed by the Holding Corp in behalf of all members of the affiliated group.*

NOTE: The taxes were paid in quarterly installments by the Reorganization Trustees and borne by the members of the affiliated group in the following amounts, respectively:

The Western Pacific Railroad Corporation	None
The Western Pacific Railroad Company (Trustees)	$4,144,828.87
Sacramento Northern Railway	2,847.58
Tidewater Southern Railway Company	53,608.94
The Western Realty Company	None
Deep Creek Railroad Co.	None
Standard Realty and Development Company	None
Delta Finance Co., Ltd.	536.15
	$4,201,821.54

*The practice of filing consolidated returns on behalf of the affiliated group was initiated by the filing of such a return for the calendar year 1918 and was continued thereafter without interruption through the period ending with April 30, 1944.

alleged that the defendant through its officers and attorneys had controlled the board of directors of the plaintiff corporation and that by reason of such control plaintiff was caused to file the consolidated returns for the benefit of the defendant. Throughout the proceedings and in the trial, this has been referred to as "duality of control."

In the supplementary complaint, the plaintiff prayed that the Court, in equity, enter a decree allocating and directing the payment of the abated taxes, amounting to some $17,000,000, to the plaintiff by way of mitigation of its losses in its subsidiary.

After many preliminary motions were made and disposed of, and after the filing of answers by the defendant and after pre-trial conferences, the cause finally came on for trial.

The trial itself consumed 13 days; the proceedings are set forth in 1700 pages of transcript; 14 witnesses testified and 164 exhibits, with various subdivisions, were introduced in evidence.

A number of special defenses were pleaded and testimony and exhibits offered at the trial in support thereof.

[265] But I am of the opinion, in view of the fact that the cause is concededly of equitable cognizance, that decision must depend upon the essential righteousness of plaintiff's claim as an equitable demand.

Discussion

The income tax picture presented is bizarre indeed. It is "paradoxical" as the defendant's tax attorneys put it.[5] The

[5]In a letter dated May 20, 1943 (plff. Ex. 50) addressed to Curry, Vice President of defendant company, tax counsel Polk set

Western Pacific Railroad Company, the operating company, profitably conducted its railroad facilities in reorganization during 1942, 1943 and the forepart of 1944. Its own profit and loss records showed the debtor to be accountable to the United States in the sum of $21,346,567 income taxes for the years 1942, 1943 and the first four months of 1944. During this same period of time the plaintiff was still the legal owner of all the capital stock of the debtor, an ownership which had been declared by both the Interstate Commerce Commission and the Reorganization Court to be valueless. But the tax attorneys for the defendant conceived a "paradoxical" plan. They [266] decided that they would file, pursuant to Section 141 of the Internal Revenue Code and the Treasury Regulations issued thereunder[6] affiliated or consolidated returns on behalf of the parent company and its subsidiaries and in them set up the plaintiff's stock loss (i.e., its ownership in the debtor) as an income tax deduction against the operating profits. Ostensibly they found their authority for so doing in Section 123 of the Revenue Act of 1942. (26 USC § 23(g)(4).[7] Thus, part of the lost $75,000,000 stockholding of the plaintiff in the debtor was applied as an offset to operating profits during each of the

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forth his idea of, using the plaintiff's stock loss in the debtor to offset debtor's profits, saying: "This is commented upon rather than suggested, since it is *paradoxical to compute a loss upon the operating company's stock which, through the mechanics of consolidated return reporting, could be used to nullify the very income of the affiliate whose stock had become worthless.*" (Italics supplied.)

[6]§ 141 Internal Rev. Code permits the filing of a consolidated return by affiliated corporations. Regulations 104 and 110 contain detailed requirements for such filing.

[7]See footnote #3.

three years in question to the end that no part of the $21,346,567 tax would be paid.

This was more than mere tax "saving"; it amounted to a complete tax "escape." But the debtor had already paid $4,144,828 income taxes for the fiscal year 1942 and it had filed a claim for refund of such taxes upon the ground that it owed no taxes for 1942 if, on the theory of "carry-back," part of the $75,000,000 stock loss was a proper deduction. So in order to make the far larger saving or "escape" offered for the three years in question, the claim for refund was waived and the Commissioner then accepted the returns for 1942-1943 and the fore part of 1944. The effect of this was that [267] the debtor paid $4,144,828 taxes to the United States in order to escape the $21,346,567 previously mentioned, or a net saving or "escape" of $17,201,739. To all of this the Commissioner agreed. It was stated to be a compromise because of some question as to the date of definite ascertainment of the stock loss. The Commissioner apparently agreed that, under the 1942 amendment (§ 23(g)4), it was proper to offset the capital stock loss against the net operating gain, and the taxpayer paid $4,144,828 to resolve some alleged uncertainty as to the date of ascertainment of the stock loss.[8]

How the amendment to the statute, (§ 23(g)4), could have been availed of by the debtor is, mildly stated, puzzling, if not downright amazing. Its application in an orthodox case is understandable. The theory of deducting

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[8]It is not at all clear to the Court how the alleged uncertainty as to the date of ascertainment of the stock loss could have been a true factor affecting the tax settlement, inasmuch as any such uncertainty would, if it existed, as well apply with respect to the 1943 and 1944 returns.

a loss in an economic aggregation of affiliated corporations, where one unit gains and the other unit loses, has been recognized and approved by Congress and the Courts.

Prior to the Revenue Act of 1938, losses resulting from the worthlessness of stocks and bonds were deductible from ordinary income and were not subject to the so-called capital-loss limitations. These limitations, that is that a capital loss could only offset a capital gain, had applied only to sales and [268] exchanges, with the result that it was more advantageous to allow stocks, that might become worthless, to become worthless rather than to sell them. By the 1938 Act losses sustained by reason of the worthlessness of securities were treated as if they resulted from the sale or exchange of capital assets and thus were subject to the limitations applying to deductions in the form of capital losses. 26 USC 23(g)4, which was Section 123 of the Revenue Act of 1942, accorded losses on worthless stocks held by a taxpayer in affiliated corporations the same treatment accorded losses from all worthless securities prior to the Revenue Act of 1938.

Research does not disclose any statement of Congressional reason or purpose for the enactment of Section 123 of the Revenue Act of 1942 26 USC 23(g)4. It was not in the original House Bill (H.R. 7378), but was an amendment added in the Senate (S. Rept. 1631, p. 89, 77th Cong. 2nd Sess.) Neither the Senate Report, nor the Conference Report of the Bill, H. Rept. 2586 (Cong. Rec. 77th Cong. 2nd Sess. p. 8401, 8441) state the reasons for the amendment. It is of interest that in the Revenue Act of 1942 (26 USC 117(i).) securities held by banks were accorded the same benefits as Section 123 accorded to affiliated corporations.

While the purpose and intent of Congress has not anywhere been precisely stated, it is a fair and justifiable inference that the intent was to enlarge the general benefits afforded by consolidated or affiliated corporate returns.

[269] It may be briefly stated that the philosophy of the consolidated return is to disregard the corporate entity and to tax as a single business or economic unit, what really is a business unit. This has been found to be sound, equitable and convenient tax procedure. It treats an affiliate group of corporations as one business enterprise, the various affiliates being considered as if they were branch offices of the main business establishment. The income from all units is considered as a single income, and the losses from all units, are treated as a single loss. See the following in this connection: Mertens, Law of Federal Income Taxation, (1942) Vol. 8, § 46.01 and § 46.02: Montgomery's Federal Taxes—Corporations and Partnerships 1948-1949, Vol. II, p. 678; Miller, "The Taxation of Intercompany Income;" Law and Contemporary Problems, 1940, Vol. 7, 301, 306; Commerce Clearing House Standard Federal Tax Reporter, 1949, Vol. 1, paragraph 200C-1. See also statement of the Acting Secretary of the Treasury, regarding the preliminary report of the Special Committee of the Committee on Ways and Means, 1933, p. 13.

In my opinion, it is crystal clear that in enacting Section 23(g)4, the Congress were merely furthering the general purposes and benefits of the statutory provisions allowing the filing of affiliated corporation returns. Obviously it intended by the provision, (23(g)4), to allow a parent company in an affiliated group, if its ownership of stock in a subsidiary becomes worthless, to offset it against other

income of the parent company in any other subsidiaries or [270] subsidiary, in the same manner, as it had been permitted to offset operating losses in one subsidiary as against operating gains in another. To assume however that the Congress intended by 23(g)4 to statutorily authorize what was done in this case, is to attribute plain stupidity to the Congress of the United States—an unthinkable procedure, despite the general habit of criticism, both fair and unfair. But here the inexplicable occurred. For $4,144,828, the United States released $21,346,567 in taxes upon a basis which is completely incomprehensible. The tax "escape" invites a type of scrutiny which this Court is powerless to give it.

Obviously the Court cannot pass judgment upon the validity of the tax compromise and settlement. It is now closed. It is final and cannot be reopened except for fraud.

I am not unmindful of the recognized and approved philosophy that a taxpayer may avail himself of every proper means of reducing his taxes.[9] In every sense of the word, however, there was a real escape from the payment of taxes here. If I had the power, I would not hesitate to set aside the tax settlement. Indeed, if I could, I would order these taxes paid to the United States. That would effectively dispose of the cause.

[271] Perhaps it may be said that it is impertinent for the Court to concern itself with a closed tax transaction and

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[9] U.S. v. Isham, 84 U.S. 496, 506; Jones v. Helvering App. D.C., 71 Fed. 2d 214, 217; Iowa Bridge Co. v. Commissioner, 8 Cir. 39 Fed. 2d 777; Commissioner v. Eldridge, 9 Cir. 79 Fed. 2d 629, 631; Mertens: Law of Fed. Taxation (1948) Vol. 10A § 61.06 at 249. Paul: Studies in Federal Taxation (1937) p. 104.

agreement such as this. But if equity principles are our guide, then this tax settlement is of the web and woof of the issue to be decided. Equity has no precise boundaries, and certainly not in this unique controversy.

If this were an ordinary and more common type of tax saving, there might be impertinence to the Court's concern with it. But this so-called "saving" is inextricably entwined with the equities. Its very nature shapes and molds these equities. It is a "pot of honey equally attractive to principals and advocates."[10] When equity is invoked to divide or distribute the "pot," it cannot be blindfolded as to the origin or nature of the "honey."

It is argued, in effect, by plaintiff that, irrespective of whether or not the tax settlement was in accord with the statute, nevertheless it is a completed transaction and a closed book and should have no place in the determination of the validity of plaintiff's cause of action. It is asserted that tax savings having been made, the only question remaining is whether or not on the record here, the defendant must turn over to plaintiff an amount equal to, or a substantial part of, the tax savings. But in my opinion, the tax escape was erroneous and unjust. It cannot be cured by committing the further inequity of distributing the gain thus made to others.

[272] Debtor, having made good its "escape," now comes plaintiff and prays for a share, if not all, of that which "escaped." Whether there was, or was not, "duality of control" respecting the directorates of the two companies, appears to me to be not too important. True, there is a preponderance of the evidence in favor of the plaintiff's con-

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[10] Breving v. Lloyd Cuarto, 84 Fed. Supp. 33, 35.

tention of "duality of control." Be that is it may, I am compelled to rest decision upon the fundamental issue of the justice and equity of plaintiff's right, if any, to be paid for that which was escaped. Analytically speaking, what the plaintiff seeks is to collect from the defendant an amount equal to all, or a substantial part of, taxes that the debtor did not pay to the United States.

What is the true nature of the claim of plaintiff and of the relief it seeks? What plaintiff really seeks is not all or a share of the so-called tax savings. Rather it is a circuitous way of obtaining something in the nature of equity or value for its ownership, rejected in the reorganization plan. Or put differently, it is an effort to share in the earnings of the debtor during the reorganization period. Essentially a so-called tax saving is but a different name for an earning. Assuming, arguendo, the validity of plaintiff's contention, its right or claim is dependent upon the debtor making earnings. If there were no earnings there could be no so-called tax saving. A "saving" in taxes is a negative concept. It is a benefit to one obligated to pay money, resulting from not having to pay. No benefit could inure [273] from participating in non-payment of an obligation, unless there rested upon the participant an obligation to pay. Absent such obligation, any sharing of that which is not paid out, would be gratuitous. In effect therefore, recognition of plaintiff's claim would be recognition of a right in plaintiff to share in debtor's earnings. As already stated, a demand substantially seeking this end was heretofore asserted by way of opposition to the plan and rejected. Ecker v. Western Pac. Co. 318 U.S. 448.

Not only that, but the philosophy underlying Section 77 of the Bankruptcy Act stands as a barrier against the equitable validity of plaintiff's claim in this cause. Rehabilitation of a debtor by readjusting its financial structure in the interest of the debtor, its creditors and the public, in a fair and equitable plan or reorganization, is the essential purpose of Section 77. If a debtor in fact has an equity, it is and should be recognized. If not, it is disregarded. Above all, Section 77 was devised to provide in the public interest both a speedy and efficient means of resuscitating, among others, sick and ailing railroads.

See: Van Schaick v. McCarthy, 10 Cir. 116 Fed. 2d 987, 992; New England Coal & Coke Co. v. Rutland R. Co. 2 Cir. 143 Fed. 2d 179, 185; In re Denver & R.G.W.R. Co., 10 Cir. 150 Fed. 2d 28, 34; Thompson v. State of Louisiana, 8 Cir. 98 Fed. 2d 108, 110; Craven "The Judicial and Administrative Mechanism of Section 77," 1940, 7 Law and Contemporary Problems 464.

[274] When it was finally determined, after running the full gamut of court and administrative procedure, in the reorganization of the Western Pacific Railroad Company, that the plaintiff's interest was worthless, nothing short of some extraordinary cause justifying reopening the reorganization proceeding could effect a change. To make any award in this cause, under the assumed authority of equity principles, would be in effect to modify the administrative and judicial judgments in the reorganization proceeding. Such a procedure would be an indirect nullification of the purpose of the reorganization statute, in the guise of an afterthought allegedly of equitable persuasion.

What was the actual result of the tax saving agreement by which it was determined that some $21,000,000 in taxes were not due to the United States? Simply that the debtor did not pay taxes. It does not follow at all from this, that an obligation to pay the unpaid tax money, one to another, was thereby created.

The so-called "duality of control," much discussed and emphasized, is not important in resolving the tendered issue. For in the final analysis, plaintiff's hope to succeed here depends upon whether it could have lawfully acquired these unpaid tax monies by voluntary agreement between the directorates of the two companies. In my opinion, it could not. For such a procedure would violate and nullify the reorganization plan and the decree of the Court confirming it. It would permit [275] the plaintiff to share in the earnings of the debtor during the period of reorganization. Equity would aid the creditors of debtor to prevent it. Indeed there is some merit to defendant's contention that a firm obligation rested upon plaintiff to conform and cooperate to the end that the creditors and new owners should be benefited to the fullest.

What would be the result if the contention of plaintiff, that law and equity imposes an obligation upon defendant to pay the whole amount of unpaid tax money over to plaintiff, were sustained? It would mean a court order directing defendant to pay over to plaintiff an amount equal to the taxes the debtor should have paid to the United States. So the plaintiff, which formerly owned and was a failure in operating the debtor, would get from the defendant a sum of money out of debtor's earnings during reorganization equal to the taxes the debtor should have paid to the United

States resulting from its profitable operations. In my opinion, such a whirligig rationale transcends all reasonable concepts of equity and justice.

An array of able counsel on both sides have put forth prodigious and ingenious efforts,[11] one side to retain the benefits of the tax "escape," and the [276] other to obtain them. And all the time the taxes escaped in reality belong to the United States.

The Court cannot cause these taxes to be paid, where they should be paid, to the United States. But, as between the parties, no persuasion of conscience or equity impels me to do otherwise than to leave the parties where they are, the defendant with its amazing and undeserved tax success; the plaintiff, as the reorganization decree left it, without interest in the debtor.

For the reasons stated, judgment will go for the defendant.[12]

Dated: September 6, 1949.

[Endorsed]: Filed September 6, 1949.

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[11]In the preparation for the trial, and to develop the historical facts concerning the controversy and upon the subject of the so-called "duality of control," the depositions of 13 witnesses were taken over a period of many months and cover 6190 pages of transcript. Briefs, on submission of the cause, total 485 printed pages.

[12]Inasmuch as there is little factual dispute pertinent to the issue decided, this opinion may well serve, under the rules, so far as necessary, as findings of fact and conclusions of law. But counsel, if they wish, may submit findings pursuant to the Rules, provided they are limited to the issues involving the essential equitable considerations upon which the decision rests.

II. Opinion and Dissenting Opinion of October 29, 1951, in the United States Court of Appeals for the Ninth Circuit.

[2213] *United States Court of Appeals*
For the Ninth Circuit

[Title of Cause]

[2214] Oct. 29, 1951

Upon Appeal from the United States District Court
for the Northern District of California
Southern Division

Before HEALY, Circuit Judge, and FEE and BYRNE, District Judges

WILLIAM M. BYRNE, District Judge:

OPINION

These are appeals from a judgment denying relief to plaintiffs below, who are seeking to recover approximately \$17,000,000 from the reorganized The Western Pacific Railroad Company, defendant and appellee.[1] Appellants are The Western Pacific Railroad Corporation (hereinafter sometimes referred to as "Corporation"), its receiver, and three of its preferred stockholders, who intervened to assert Corporation's claims.

Appellant Coporation, from 1916 until the events which gave rise to this litigation, owned all of the capital stock of The Western Pacific Railroad Company, an operating rail-

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[1]There are seven appellees who are an affiliated group. The only one from whom appellants seek a money judgment is The Western Pacific Railroad Company, hereinafter sometimes referred to as the "subsidiary". The term, "subsidiaries", used in the plural number, refers to The Western Pacific Railroad Company and all other members of the affiliated group of which appellant "Corporation" was the parent.

Order entered by Reorganization Court confirming plan of reorganization and approving designation of Reorganization Committee.

November 22, 1943—

Agreement executed between Holding Corp, its secured creditors and Reorganization Committee providing *inter alia* for the transfer of the preferred and common stock of the Debtor to the Reorganization Committee.

December 17, 1943—

Order entered by Reorganization Court approving agreement of November 22, 1943, and authorizing and directing transfer of preferred and common stock of the Debtor to the Reorganization Committee.

May 1, 1944—

Preferred and common stock of Debtor, owned by Holding Corp, transferred to the Reorganization Committee pursuant to agreement of November 22, 1943, and order of Reorganization Court entered December 17, 1943.

September 25, 1944—

Order entered by Reorganization Court approving use of the Debtor in carrying out and making effective the plan of reorganization.

September 25, 1944—

Order entered by Reorganization Court approving and authorizing mortgage indentures, forms of bonds, interest coupons, etc. This order also authorized the making of "adjustment payments" to persons to whom new securities were issuable under the reorganization plan and further provided that, after the making of payments for certain specified purposes, the balance of the available net income of the Debtor and its subsidiaries for the years 1939 to 1943, inclusive, could be applied "to any proper corporate purpose of the reorganized company."

October 24, 1944—

Report and order of Interstate Commerce Commission authorizing the issue of new securities, transfer of property, etc.

(This order requires that both the first mortgage bonds and the general-mortgage income bonds to be issued under the plan "will be dated January 1, 1939" and that the certificates for the shares of both preferred and common stock to be issued under the plan "will be dated January 1, 1944.")

November 27, 1944—

Order of Reorganization Court directing the revesting of properties of the Debtor in the Reorganized Company, authorizing and directing the carrying out of the plan, and fixing December 29, 1944 as "The date for the consummation of the plan of reorganization * * *."

December 29, 1944—

Reorganization plan consummated and title to all business, assets and property constituting the Debtor's estate, and all title and interest of the Reorganization Trustees revested in the Reorganized Company pursuant to deed of

March 3, 1944—

Order entered by Reorganiza
of $7,100,000 for contingent t

May 1, 1944—

Preferred and common stock
to agreement of November 2
"affiliation," theretofore exist

May 15, 1944—

Order entered by Reorganiza
ment of estimated Federal i
United States Treasury Savi
therefor matures.

July 15, 1944—

Consolidated income and ex
Holding Corp in behalf of a

NOTE: The declaration of worth
certified by the Interstate Comme
greatly exceeded what would othe
and no tax was reported or paid f

March 3, 1944—

Order entered by Reorganization Court authorizing Reorganization Trustees to establish a reserve fund in the amount of $7,100,000 for contingent tax liability for 1943.

May 1, 1944—

Preferred and common stock of Debtor, owned by Holding Corp, transferred to Reorganization Committee pursuant to agreement of November 22, 1943, and order of Reorganization Court entered December 17, 1943. The status of "affiliation," theretofore existing between the Holding Corp and other members of the group, was thereby terminated.

May 15, 1944—

Order entered by Reorganization Court authorizing Reorganization Trustees to invest funds, accumulated for the payment of estimated Federal income and excess profits taxes accruing from month to month during the year 1944, in United States Treasury Savings Notes, Series C, to be used for the payment of such taxes as and when the liability therefor matures.

July 15, 1944—

Consolidated income and excess profits tax returns for the calendar year 1943, showing no taxable income, filed by Holding Corp in behalf of all members of the affiliated group.

NOTE: The declaration of worthlessness of the stock of the Debtor owned by the Holding Corp as provided in the plan of reorganization certified by the Interstate Commerce Commission and confirmed by the Reorganization Court, resulted in a loss to the Holding Corp which greatly exceeded what would otherwise have been the taxable income of other members of the affiliated group for the calendar year 1943 and no tax was reported or paid for that year by any member of the group.

road company. The operating company became financially distressed during [2215] the "depression of the early thirties" and in 1935 it filed a petition under Section 77 of the Bankruptcy Act (11 U. S. C. 205). The court, in that year, placed its affairs in the hands of trustees. In 1939 the Interstate Commerce Commission approved (233 I. C. C. 409) a proposed plan of reorganization, which was thereafter submitted to and approved by the district court in 1940. In the plan it was determined, inter alia, that the capital stock of the subsidiary, owned by Corporation, was without equity or value and therefore was not entitled to participate in the plan. Appeals followed and, after a contrary holding by this court, the Supreme Court considered and rejected the contention of Corporation that it should have the right to participate in the plan because of increased earnings of the debtor while in reorganization, and affirmed the district court on March 15, 1943.[2] Thereafter the plan of reorganization was submitted to the creditors in accordance with the statutory requirement (11 U. S. C. 205(e)), and, following their approval, was confirmed on October 11, 1943 by the district court. On April 30, 1944, with the approval of the court, Corporation transferred all of its stock in the subsidiary to the reorganization committee and this stock was later cancelled. On December 31, 1944, the trustees turned the railroad properties over to the reorganized company, The Western Pacific Railroad Company, appellee here.

This litigation involves a dispute about taxes and [2216] tax savings for the years 1942, 1943 and the first four months of 1944, a period during which the railroad properties were

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[2] Ecker vs. Western Pacific Railroad Corp., 318 U. S. 448.

controlled and operated by the trustees of the bankruptcy court.

During the years in which Corporation was the owner of all the outstanding stock of the pre-reorganization, The Western Pacific Railroad Company, including the years the trustees of the bankruptcy court had possession and control of the railroad properties, Corporation followed the practice of filing consolidated income tax returns in which it reported the earnings of the operating company as well as other affiliated companies.

During the year 1942 the operating company, under the control of the court's trustees, had substantial net earnings. On May 15, 1943, a consolidated return for the calendar year 1942, showing tax liability of $4,201,821.54, was filed by Corporation in behalf of all members of the affiliated group. Corporation, not having had any net earnings during 1942, did not pay any part of the tax.

On July 15, 1944 consolidated income and excess profits tax returns for the calendar year 1943, showing no taxable income, were filed by Corporation in behalf of all members of the affiliated group. The operating company, under the management of the trustees, again made substantial net earnings in 1943, but the loss sustained by Corporation by reason of the declaration of worthlessness of its stock[3] in the operating company (which had cost [2217] Corporation $75,000,000) was utilized as an offset in the consolidated returns and thus resulted in a net loss and no tax obligation

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[3]Section 123 of the Revenue Act of 1942. (26 U.S.C. 23(g)(4)). By this subsection, losses resulting from worthlessness of stock of an affiliate became operating losses instead of capital losses as theretofore.

for any of the affiliated group. In addition, part of the loss was "carried back" to 1942[4] and a claim for refund of the taxes paid under the consolidated return for 1942 was filed with the Commissioner by Corporation on March 9, 1945. A consolidated return in behalf of the affiliated group was filed on June 15, 1945 by Corporation for the first four months of 1944. No tax liability was shown by this return by reason of the "carry forward"[5] of an unused portion of the loss arising from the declaration of the worthlessness of the stock of the subsidiary company owned by Corporation.

The validity of the stock loss offsets was questioned by the Commissioner of Internal Revenue, and after negotiations a tax settlement was made with the Commissioner on August 13, 1947 whereby, in consideration of the withdrawal of the claim for refund of 1942 taxes, the Commissioner accepted and approved the returns for the calendar year 1943 and first four months of 1944. Except for the offset of the capital stock loss of Corporation, the [2218] net earnings of the subsidiaries for 1943 and the first four months of 1944 would have required the payment of some $17,000,000 in income and excess profits taxes.

This suit in equity was instituted October 10, 1946 by Corporation, alleging "consolidated income tax returns were filed by the plaintiff for itself and its affiliates which reported a deductible loss by the plaintiff in an amount sufficient to eliminate all taxable income for the group as a whole" for the periods in question and praying that the

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[4]Section 122(b)(1) of the Internal Revenue Code. (26 U. S. Code)

[5]Section 122(b)(2) of the Internal Revenue Code. (26 U. S. Code)

rights and interests of the plaintiff and the defendants be fixed and determined. A complaint in intervention was filed by three stockholders of Corporation on April 7, 1947. The principal difference between the original complaint and the complaint in intervention is the allegations in the latter pertaining to "duality" or interlocking management and "domination" of the parent by the subsidiary. It is alleged that various directors, officers and counsel of Corporation acted as directors, officers and counsel of the subsidiary with the result that the subsidiary dominated and controlled Corporation; that said officers caused Corporation to file consolidated tax returns when Corporation had "no duty or obligation whatsoever so to do". Corporation filed an answer to the complaint in intervention in which it denied "on its own behalf and on behalf of its officers and directors all allegations . . . of domination and control of the plaintiff, its officers and directors" by the subsidiaries and affiliates, *but six months later* Corporation filed a supplemental bill of complaint [2219] alleging a "duality of control" and, though falling short of intervenors' allegation of "domination", it alleges "at the special instance and request of the defendants and the trustees in the reorganization proceedings acting for the defendants the plaintiff, however, consented to the filing on its behalf of consolidated . . . tax returns with defendants" for the tax periods in question. It is further alleged that plaintiff "does not aver that in so conducting themselves" the officers acting for both corporations "were aware of wrong-doing or consciously disregarded the interests of plaintiff". There is no assertion of actual fraud or specific acts of deceit nor would the record support any such assertion. Corporation's claim appears to

rest on constructive fraud presumed from the intercorporate relationship which it asserts deprived it of its independence and caused it to suffer a loss.

The appellants emphasize that Corporation maintained its offices jointly with those of its subsidiaries and the trustees in New York; that Corporation's officers, who handled the tax transactions, were also employees of the subsidiaries and trustees, and their salaries and the expenses of the office were jointly paid; that because of its impoverished financial condition, Corporation was incapable, as of June 1, 1943, of paying salaries or office expenses and thereafter the subsidiaries paid all of the salaries and office expenses. Appellants refer to this as "duality of management" which they contend created a fiduciary relationship and the subsidiaries' duty to deal fairly with Corporation.

[2220] Many of the cases cited by appellants deal with the duties of trustees, agents and partners and with the granting of restitution for violation of their duties. Clarity of reasoning has suffered because of the failure to distinguish between the several varieties of fiduciaries and the duties imposed on each. Although all trustees are fiduciaries, all fiduciaries are not necessarily trustees.

> "A person in a fiduciary relation to another is under a duty to act for the benefit of the other *as to matters within the scope of the relation.* Fiduciary relations include among others the relation of trustee and beneficiary, guardian and ward, agent and principal, attorney and client . . . The directors and officers of a corporation are also fiduciaries, as are receivers, and executors and administrators. *The scope of the transactions affected by the relation and the extent of the duties im-*

posed are not identical in all fiduciary relations . . ." (Restatement of Restitution, Section 190, comment "a".) (emphasis added.)

As stated by Professor Scott in 49 Harvard Law Review at page 521:

> "*In some relations the fiduciary element is more intense than in others; it is peculiarly intense in the case of a trust . . .*" (emphasis added.)

Appellants place a great measure of reliance on the case of *Commercial National Bank in Shreveport vs. Parsons*, 144 F. 2d 231. That case is distinguishable from the case before us in that the fiduciary relationship arose out of a contract which imposed the *duties of a trustee* upon the "new [2221] bank". The court decided the case on the established rule that a *trustee* owes the duty of absolute fidelity to the *trust estate* and may not profit by dealing with it. We know of no better way to point up the distinction than to use the words of the court cited and emphasized by appellant's brief:

> "The credit thus obtained by the new bank was a profit derived from the *trust property* as effectively as if it had been paid that much in cash." (emphasis added.)

Cases which deal with trustees, agents and partners are not controlling here as there is no contention that the subsidiary was a trustee, agent or partner. It is appellants' contention that the subsidiary dominated Corporation through the dual officers. If this be true, then a fiduciary relationship existed, but the duties imposed were not those of a trustee. While a trustee *may not deal* with the trust estate and thereby make a profit, affiliated corporations are usually

associated for the very purpose of dealing with each other for profit, e.g., manufacturing and sales companies; railroads and their subsidiary short line companies. Even the corporation which dominates its subsidiary, with the resultant fiduciary relationship, properly deals with its affiliate for profit *as long as there is no overreaching or unfairness.*

Whether or not a fiduciary relationship exists, and the extent of the duties imposed, depends upon the particular field of substantive law involved. We must look to the law of corporations to determine whether the subsidiary stood in a fiduciary relation [2222] to Corporation. The mere fact of officers and directors in common does not create such a fiduciary relationship. There is nothing insidious about duality of management and control as such. It is very common in the realm of business, particularly in the situation of parent and subsidiary, as here. At times business convenience requires such relationship. The *officers and directors* who occupy this dual position are fiduciaries to both companies and owe a duty of loyalty to each. Thus they cannot favor the interests of one corporation while sacrificing or betraying those of the other. If they do so, they must respond in damages for their tortious conduct or account for any benefits derived through their breach of duty.

But rules relating to the individual officers do not reach the point involved in this case. Here we must determine whether *the subsidiary corporation* stood in a fiduciary relation to *the parent corporation.* There are several orthodox ways in which one corporation may become a fiduciary in relation to another corporation, e. g., it may hold property

in trust for the other, or it may become an agent for the other. Fiduciary duties also arise where one corporation dominates the other. *Consolidated Rock Co. v. Du Bois,* 312 U. S. 510. Although the presence of common officers and directors does not in itself create a domination or a fiduciary relationship between the corporations, it does subject dealings between them to judicial scrutiny as to their fairness and reasonableness to ascertain if domination exists, and if so, whether it has resulted in [2223] overreaching which will raise a presumption of constructive fraud.

There obviously existed an interlocking management between Corporation and the subsidiaries. But this situation was not of the subsidiary's making. On the contrary, it was created by Corporation, whose stockholders elected its Board of Directors, who appointed its officers. Since plaintiff Corporation owned 100% of the stock of the subsidiary, it elected all of the directors of the subsidiary, which, in turn, appointed its officers. After the subsidiary was reorganized it was no longer controlled by Corporation but by the trustees appointed by the bankruptcy court.[6] Corporation continued in office the same directors who, in turn, continued to employ the same officers. This was not unnatural since Corporation continued to own all the capital stock of the subsidiary long after it had been divested of control of the subsidiary by reason of the reorganization.

If it be assumed that the advent of the trustees into the affiliation and the increased prosperity of the subsidiary resulted in control of the affairs of Corporation so as to

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[6]The name of one of the trustees was submitted to the court by Corporation and the other was selected by the court and approved by all interested parties in the bankruptcy proceeding.

raise fiduciary obligations, the scope and extent of the subsidiary's obligations would be to deal fairly with Corporation. A corporation can only act through its officers and agents. It follows that if there was domination and [2224] unfairness it was exercised through the dual officers who forsook their obligations to Corporation, by which they were appointed, and served the purposes of the subsidiary. Although the arguments of appellants are exceedingly general, it is apparent that they assign three particulars wherein the dual officers failed in their obligations to Corporation, resulting in unfairness: (1) They filed consolidated returns; (2) they failed to exact an agreement from the subsidiary requiring payment of money to Corporation as a condition to their consent to file consolidated returns; (3) they should have resigned and allowed the appointment of successors who would have exacted such an agreement from the subsidiary. We shall discuss these three particulars seriatim.

The consolidated returns were filed by Corporation as the parent, for itself and its subsidiaries. Appellants contend that the subsidiaries caused[7] Corporation to file consolidated returns when it had "no duty or obligation whatsoever so to do". The filing of these returns was in exact conformity with the practice followed since 1916. Beginning in 1927 Michael J. Curry, first as treasurer and after February 1, 1942 as president of Corporation, supervised preparation of

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[7]Appellant Intervenors attribute the "causation" to "domination and control" of Corporation by the subsidiaries and trustees, whereas Corporation, which denies "domination and control" merely attributes it to its consent to the filing "at the special instance and request of the defendants and the trustees . . ." (pleadings)

consolidated returns, [2225] signed and filed them. In each year the consolidated tax liability was distributed pro rata to those members of the group who had taxable incomes without allocating any tax to a company showing a loss or paying such company tribute for the tax "saved" by the use of its loss in the returns. Mr. Curry supervised preparation of tentative tax returns for 1942, and on March 15, 1943 signed and filed them and arranged for an extension of time until May 15, 1943 to file the final returns. On March 23, 1943, F. C. Nicodemus, Jr., who was counsel for Corporation at the time and *appears on the pleadings and briefs in this case as present counsel for appellants,* suggested by letter[8] to Mr. Schumacher, one of the trustees of the operating company, that he be authorized to employ Messrs. Whitman, Ransom, Coulson & Goetz, tax experts, to advise him on tax matter. This was done. Mr. Polk of this firm continued to advise with the officers of the group through the periods here in question. Mr. Polk reviewed the tax situation with Mr. Curry and Mr. Nicodemus and on May 20, 1943 prepared a detailed written report[9] addressed to Mr. Curry and circulated to Mr. Schumacher and Mr. Nicodemus. The report reviewed the tax advantages of consolidated returns and suggested the possibility that, under the recently enacted amendment to Section 23(g) of the Internal Revenue Code, the loss of Corporation, upon a [2226] determination that its stock in the subsidiary was worthless, might constitute under a consolidated return, an offset to income of other group members. A consolidated return reporting the

[8] Pl. Ex. 39B (read into record, page 544)

[9] Pl. Ex. 50

loss of Corporation as an offset to group income was prepared in the joint New York office, signed by Mr. Curry, and filed by him on July 15, 1944. The returns reported no tax owing. Substantially the same procedure was followed for the "carry back" claim for refund March 9, 1945, as well as the consolidated tax returns for the first four months of 1944, which were filed July 15, 1945.

It hardly seems conceivable that Corporation could complain because consolidated returns were filed. Not only was it in accordance with past practice of the group and under the supervision of Corporation's president, as in former years, but it was done under the guidance of the independent tax experts employed upon the suggestion of the General Counsel for Corporation, who *represents appellants in* the present proceeding. As the trial court stated[10] ". . . when everybody was, as they were in this case, acting completely in the open in the matter; nobody was concealing anything from anyone else, the element of fraud or deception, of the kind that you refer to, is absent . . . Everybody knew that consolidated returns were being filed . . . Everybody knew that these attorneys were being employed to file this consolidated return. It was all done right out in the open." At the time [2227] of trial plaintiff intervenors appeared to agree with these observations of the trial court,[11] but on this

[10] Page 970, Transcript.

[11] Page 971, Transcript: "The Court: Well, all I have to say to you there, Mr. Levy, is that I don't think it is necessary to carry that argument forward now. Everybody knew, didn't they, that the consolidated return was being filed? So that the defendant railroad company wouldn't have to pay any income tax? That was why it was filed, wasn't it?

"Mr. Levy: Yes, your honor."

appeal they infer that there was something sinister about the filing of the consolidated returns.

It is interesting to note the reactions of appellants to observations in the opinion of the trial court[12] to the effect that the Commissioner erred in allowing the tax deduction in question. They vehemently argue that the filing of the consolidated returns and the use of plaintiff's loss to offset defendant's income was proper under the tax law and regulations. It is also interesting to note that the compromise of the tax claim between the Bureau of Internal Revenue and Corporation acting through its attorney-in-fact, James K. Polk, [2228] occurred *after* this action was commenced on October 10, 1946, and *after* the filing of the complaint in

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[12]In the opinion filed by the trial court (85 F. Supp. 868), appears the expressed view that the Bureau of Internal Revenue should not have compromised the tax claim of the taxpayers and should have insisted that the claimed deductions be disallowed in their entirety. The court said, "If I had the power, I would not hesitate to set aside the tax settlement. Indeed, if I could, I would order these taxes paid to the United States. That would effectively dispose of the cause." While we agree with the principal holding of the trial court, we do not share this view. A taxpayer may avail himself of every means of tax deduction proper under the applicable statutes. Here the Commissioner questioned the taxpayer's right to the deduction and, after months of negotiation, compromised the disagreement with the taxpayer in lieu of litigating it in the Tax Court. The tax laws authorize the Commissioner to enter into compromises and they are binding on the court in the absence of fraud. This is particularly true in a collateral proceeding. The settlement of the tax claims is an undisputed fact in this case and whether or not it was advantageous to the government is not in issue. The trial court recognized the expression of this view as dictum when it stated: "Obviously the Court **cannot pass judgment upon the validity of the tax compromise and settlement.** It is now closed. It is final and cannot be reopened except for fraud." (emphasis added)

issued under the plan will be dated January 1, 1944.)

November 27, 1944—

Order of Reorganization Court directing the revesting of properties of the Debtor in the Reorganized Company, authorizing and directing the carrying out of the plan, and fixing December 29, 1944 as "The date for the consummation of the plan of reorganization * * *."

December 29, 1944—

Reorganization plan consummated and title to all business, assets and property constituting the Debtor's estate, and all right, title and interest of the Reorganization Trustees, revested in the Reorganized Company pursuant to deed of the Reorganization Trustees.

December 31, 1944—

Possession, control and operation of all business and properties of Debtor transferred to and accepted by the Reorganized Company at 12 o'clock midnight, Pacific War Time.

April 30, 1945—

Ninth and Final Report and Accounting by the Trustees and petition for approval of their acts and accounts and for their discharge as Trustees filed in Reorganization Court.

May 21, 1945—

Order entered by Reorganization Court approving and confirming Ninth and Final Report and Accounting by Reorganization Trustees, approving and confirming their acts and accounts and discharging them as Trustees.

March 18, 1946—

Petition filed in Reorganization Court by Reorganization Committee for approval of their expenses and for a final order terminating the proceedings.

March 28, 1946—

Final order entered by Reorganization Court approving the report of Reorganization Committee, discharging the Committee and terminating proceedings.

(By this order the Court finds, *inter alia*, that the plan of reorganization has been fully and properly carried out and put into effect.)

March 9, 1945—

Claim filed with Commissioner of Internal Revenue for refund of the income and excess profits taxes in the sum of $4,201,821.54 paid under consolidated returns for 1942.

NOTE: This claim was based largely upon a "carry back" of an unused portion of the loss arising from the declaration of the worthlessness of the stock of the Debtor owned by the Holding Corp.

June 15, 1945—

Income and excess profits tax returns filed by the Holding Corp for the year 1944, showing no taxable income. These returns included the members of the affiliated group for the first four months of 1944.

NOTE: No tax liability was shown by these returns by reason of the "carry forward" of an unused portion of the loss arising from the declaration of the worthlessness of the stock of the Debtor owned by the Holding Corp.

June 27, 1946—

Institution of suit by Van Kirk, et al., in the right of the Holding Corp and for the benefit of its stockholders, in the United States District Court for the Southern District of New York against the Reorganized Company, the directors of Holding Corp, the James Foundation, and others, seeking *inter alia* to recover the tax savings alleged to have been realized through the filing of consolidated tax returns for 1942, 1943 and the first four months of 1944.

NOTE: *The institution of this suit marks the first assertion of any claim that the Holding Corp should have been compensated for the use of its stock loss in the consolidated returns.*

October 10, 1946—

Institution of suit by Holding Corp against the Reorganized Company, et al., in the United States District Court for the Northern District of California, seeking to recover the tax savings alleged to have been realized through the filing of consolidated returns for 1942, 1943 and the first four months of 1944.

March 9, 1945—
Claim filed with Commission
$4,201,821.54 paid under con
NOTE: This claim was based larg
of the stock of the Debtor owned by
June 15, 1945—
Income and excess profits tax
returns included the member
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June 27, 1946—
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of its stock loss in the consolidated
October 10, 1946—
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the Northern District of Cal
of consolidated returns for 1

intervention on April 7, 1947; that no effort was made to invoke the power of the court to enjoin the officers of Corporation from continuing in their efforts to have the Bureau accept the consolidated returns as filed; that nothing was done to revoke Polk's power-of-attorney to represent Corporation in the proceedings before the Bureau; that Polk, as attorney-in-fact for Corporation, made an offer of settlement of tax liability for 1942, 1943 and the first four months of 1944 by letter of May 19, 1947 to the Internal Revenue Bureau; that a stipulation (hereafter discussed) was entered into between counsel in this case approving the settlement of the returns with the Government; that Corporation's Board of Directors adopted a resolution approving [2229] and ratifying the offer of settlement August 13, 1947.

The conclusion is inescapable that Corporation's officers, when they filed consolidated returns, did not violate any obligation but, on the contrary, were conforming with the policy and directions of Corporation.

Appellants suggest that Corporation was under no obligation to file consolidated returns; that it could have demanded that the subsidiaries enter into an agreement to pay it a sum of money as a pre-requisite to its consent to filing such returns; that inasmuch as it officers did not exact such an agreement, they failed in their obligation to Corporation and are chargeable with an "unfair" omission to be imputed to the subsidiary by reason of the supposed domination.

Section 141(a) of the Internal Revenue Code grants the privilege of filing consolidated returns upon the condition that all members of the affiliated group consent to the regulations prescribed by the Commissioner under the authority

of subsection (b) of the same section. Regulation 104, Section 23.12 provides that the consolidated return shall be made by the parent corporation. Under the Regulations, the parent corporation is the agent for the entire group, and (except in unusual circumstances) all dealings with the Commissioner are handled by the parent.

Appellants argue that consolidated returns were designed solely for the benefit of the parent corporation. The argument is not sound. The Code [2230] and Regulations recognize that the benefit of consolidated returns is for all corporations in the group: Any subsidiary in the group, as well as the parent, may prevent the filing of consolidated returns if the filing is detrimental or contrary to the interests of such corporation. Appellants assert that in the usual case the tax saving which a subsidiary effects will enure to the parent by way of increasing the value of its stock or by way of dividends. This is quite true in the usual case. But it does not mean that this result must follow, nor does it follow that, because the value of a parent's equity in a subsidiary corporation is increased by reason of benefits flowing to the subsidiary's preferred stockholders and creditors, it may receive the benefits direct, regardless of the rights of the subsidiary's preferred stockholders, creditors and minority common stockholders.

The appellants and intervenors contend that the tax laws require "economic unity" for the filing of consolidated returns. This is incorrect. The Regulations suggests procedure in cases where a subsidiary has left the affiliated group. Regulation 104, Section 23.12(e). Thus, the regulations specifically envision situations where economic unity shall cease and yet permit the filing of consolidated returns. If,

by the time the returns are filed the affiliation has ceased to exist, any benefits to the subsidiary obviously cannot insure to the parent. That is precisely the situation in the case at bar. In the tax periods involved there was an affiliated group. When the returns and the claim for refund were [2231] filed, affiliation no longer existed. Therefore, the benefit of the consolidated return could not accrue to the parent corporation. If the assertion of appellants that consolidated returns "are not permitted for the benefit of the subsidiaries" were literally true, then there would be no lawsuit here because consolidated returns could not have been filed in the first instance.

Appellants cite three decisions of the Securities and Exchange Commission in support of their view that the rationale of the tax laws requires that any benefits resulting from the tax laws should go to the parent.[13] These decisions do not support this contention of appellants. These companies were seeking the approval of the Commission to alteration of inter-company agreements respecting income taxes. All three decisions show a decided viewpoint that the tax savings from consolidated returns *shall not* be paid over to the parent if this would in any way endanger the position of the creditors of the subsidiary. They also make clear that a company whose loss was utilized for the benefit of the group does not have a right to compensation from those who

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[13] In the Matter of Consolidated Electric & Gas Co., 15 S.E.C. 161; In the Matter of Consolidated Electric and Gas Co. and The Islands Gas and Electric Co., 13 S.E.C. 649; In the Matter of Cities Service Company and Cities Service Refining Corporation, Holding Co. Act of 1935, Release #5535, File 70-988.

benefited. In the Cities Service case, supra, the Commission said:

"... we think it should be observed that in [2232] the ordinary case the fact that one subsidiary contributes a particular income deduction to a consolidated return *does not in itself entitle that subsidiary to the benefits of the reduced taxes* resulting from the deduction. Where the reductions are possible from filing a consolidated return, they ordinarily are due to a number of factors contributed by the various members of the consolidated group, including, among others, earnings, and excess profits tax credits, as well as income deductions." (emphasis added)

There is nothing in the Code or Regulations that compels the conclusion that a tax saving must or should enure to the benefit of the parent company or of the company which has sustained the loss that makes possible the tax saving.

Assuming, as we have, that the subsidiary dominated Corporation through control of the dual officers, it did not abuse its supposed dominant position because the officers and directors common to both corporations did not sacrifice Corporation's interests to those of the subsidiary. When the Supreme Court decided that Corporation could not participate in the increased earnings of the operating company while in reorganization, Corporation suffered a severe loss. Since it had no income, there was no possible way for it to achieve any tax advantage to offset the loss. But its affiliate did have use for the loss and the group was entitled, under the tax law, to make use of that means of tax savings. The dual officers owed fiduciary duties to both corporations to promote the interests of both and [2233] to obtain for each what it was entitled to under the tax laws. Under this state

of facts these officers had a positive duty to make use of the loss as they did, that is, to offset the income of members of the affiliated group with deductible losses of other members. If the positions of the corporations were reversed and the subsidiary had a loss and the parent had income, the officers would have been obliged to file consolidated returns to enable Corporation to make use of the loss. Indeed, this very thing had occurred in previous years of the affiliation and Corporation had effected substantial tax savings (Def. Ex. 46) by reason of filing consolidated returns. The record is clear that on none of these occasions was tribute paid to a subsidiary which had suffered a loss. The officers would have been derelict in their duty to the subsidiary had they failed to file consolidated returns. Their duty to Corporation required only that they not sacrifice its interests and did not require them to exact tribute for following the practice of the past twenty-five years. After the transaction Corporation was in exactly the same position that it was in before the subsidiary had effected the tax saving allowed by the tax laws.

However, it is contended that the subsidiary should have notified the Corporation's stockholders and directors of the filing of consolidated returns so that independent directors and officers could have been put in charge of Corporation's interests to make a bargain with the subsidiaries and obtain compensation as a prerequisite to filing consolidated [2234] returns. There are several things wrong with this argument. The most obvious is that the entire transaction was open and above board. Many persons having an interest in Corporation, including stockholders and counsel, were fully aware of the situation. They chose not to act. They appar-

ently preferred to permit the transaction to stand, intending thereafter to bargain for a share in the tax savings. They made no effort to inject themselves into the tax settlement with the government. But all this assumes that it would have been proper for Corporation to have made such a bargain. The Corporation was the sole owner of the subsidiary's capital stock. As such it was under a duty to deal fairly with the subsidiary having full regard for the interests of the creditors and holders of other securities. *Consolidated Rock Co. v. DuBois,* 312 U. S. 510, 522. It owed a duty not to require its subsidiary to forego a legitimate tax saving and could not bargain to perform its duty. A parent company is not acting in the best interests of its subsidiary when it seeks to appropriate to itself an advantage which the tax laws give the subsidiary.

Plaintiff argues that it was a "complete stranger" to defendant when the consolidated return was filed July 15, 1944 because the affiliation terminated on April 30, 1944 when its stockholdings were transferred to the reorganization committee. A tax return is an historical document relating to the past. This return related to a period when the affiliation existed. All fiduciary duties with respect to matters arising during the relationship continue during the [2235] winding up period, and are "as sacred and inviolable after as before the expiration of its term".[14] It would be ridiculous to say that a fiduciary who performs an act

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[14] Trice v. Comstock, 121 Fed. 620, 625 (C.C.A. 8, 1903);
Uniform Partnership Act, 7 U.L.A. Sec. 30;
Cal. Corp. Code Sec. 15030;
3 Scott on Trusts (1939) Sec. 344;
16 Fletcher, Corporation (Perm. Ed.) Sec. 8174.

winding up matters which relate to the affiliation period may exact payment merely because the relationship has technically terminated. If Corporation had required tributed as a condition of its cooperation, then it would have been acting with less than the required standard of fairness to the subsidiary's creditors. Equity will not permit a recovery as a substitute for a bargain which would have been unfair.

The record is barren of evidence to support the contention that Corporation was dominated by the subsidiary, or that there was a breach of any duty owed to Corporation. As the trial court stated, "The so-called 'duality of control' much discussed and emphasized, is not important."

Appellants contend that they have a special claim to the 1942 tax saving. They rely upon a pretrial stipulation and order. The proposed settlement of tax liability with the government provided that the returns for 1942, 1943 and first four months of 1944 were to be approved as filed, and that the claim for refund of 1942 taxes was to be rejected. Intervenors applied to the court below for an order restraining the consummation of the settlement on [2236] the theory that the rejection of the 1942 refund claim might be prejudicial to the position of Corporation in this litigation. The parties entered into a stipulation providing that *for purposes of litigation* the 1942 refund claim, diminished in proportion to the diminuation of the entire tax saving, should be deemed to have been allowed and "paid to the plaintiff *as the agent for the affiliated group* . . ." (emphasis added). The pretrial order confirmed the stipulation.

The trial court did not make formal findings of fact and conclusions of law, but relied upon section 52(a) F.R.C.P., which provides in part: ". . . If an opinion or memorandum

of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein . . ." Findings of fact and conclusions of law are intended to aid appellate courts by affording them a clear understanding of the basis of the decision below. Findings are not a jurisdictional requirement of appeal which this court may not waive. Even in cases where there are no findings, if the record is so clear that the court does not need them, it may waive the defect on the ground that the error is not substantial in the particular case.[15]

In the instant case the trial court's opinion discloses adequately the issues of fact which were before the court and the court's findings thereon.

The trial court, in a note appended to its opinion, [2237] stated that "inasmuch as there is little factual dispute" the opinion would serve as findings of fact and conclusions of law, but "counsel if they wish, may submit findings . . .". All parties elected not to submit additional or more detailed findings except that the appellants proposed findings with respect to the above stipulation and pretrial order, and also a conclusion of law to the effect that the defendant should pay to the plaintiff the sum of $3,385,290. These proposed findings and conclusions, which were inconsistent with those embodied in the opinion, were rejected by the trial court.

Appellants argue that the court below concluded that it should leave the parties where it found them and that Corporation is therefore entitled to the assumed avails of the reduced refund claim.

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[15] Mayo v. Lakeland Highlands Canning Co., 309 U. S. 310; Hurwitz v. Hurwitz, 136 F. 2d 796; Goodacre v. Panagopoulos, 110 F. 2d 716.

The stipulation and pretrial order were entered into and made for the purpose of protecting the position of Corporation in relation to the refund claims *only* if it should be found entitled to the refund. *The court found it was not entitled to it.* Appellants' position is no stronger with respect to the refund for 1942 taxes paid by the subsidiaries than it is with respect to the 1943 and 1944 savings of the subsidiaries. It is true that the government requires consolidated returns be filed in the name of the parent and that refunds are paid to the parent, but where such refunds are paid, the parent holds the refund as agent or trustee for the benefit of the affiliate which has overpaid.[16]

[2238] In their brief appellant-intervenors allude to the losses they sustained as stockholders and imply that they have an equitable right to compensation apart from that of Corporation. To believe this would be to misapprehend their position. A corporation is a legal entity separate and distinct from its stockholders and benefits to the latter flow from the rights of the corporation. If this were not true these intervenors could not hope to gain by this proceeding as *they* sustained no loss by reason of Corporation being barred from participation in the reorganization plan. Their pleadings, as well as a stipulation filed in this suit, show that they acquired their stock after Corporation's stock in the subsidiary had been declared worthless. Defendants offered to prove at the trial that intervenors purchased their stock for less than one cent on the dollar. The offered evidence was properly excluded as irrelevant by the trial court. The fact, if it be a fact, that any or all of the present stockholders of Corporation acquired their stock as a speculation

[16]Bankers Trust Co. vs. Florida East Coast, etc., 92 F. 2d 450.

while the corporation was in the process of liquidation and its "stock was of trifling value" (page 11, intervenors' opening brief), is irrelevant to the issues here. Corporation is an entity and the issue is whether or not it is entitled to recover $17,000,000 from the successor of its former subsidiary. If it prevails its stockholders are entitled to reap the benefit, regardless of when they became such, or how "trifling" a sum they paid for their stock. The intervenors recognized this when they [2239] filed their complaint in intervention to *assert Corporation's claims.*

We have examined the other authorities cited by appellants and find nothing contrary to our holding here. Appellants cite *Southern Pacific Company v. Bogert,* 250 U.S. 483, 492. That case was not concerned with the question of fiduciary relationship between parent and subsidiary. Rather, it was concerned with the fiduciary duty owed by the holders of the majority of the stock of a corporation to the minority stockholders. The case holds that a parent company has a fiduciary duty to any minority stockholders of the subsidiary.

Also cited is *North American Co. v. S. E. C.,* 327 U. S. 686, 693. That case is not in point either. The court was not concerned with any question of fiduciary relationships. Rather it was concerned with the validity of the so-called "utility holding company death sentence" provision of the Public Utilities Holding Company Act.

The judgment is affirmed.

JAMES ALGER FEE, District Judge, dissenting:

There are no findings of fact which support the judgment of the Trial Court or the affirmance thereof by a majority of this Court.[1] The cause should be remanded for this reason

alone.[2] The Trial Court gives two reasons for decision against plaintiff: first, that the "tax escape" was a fraud on the government, and, second, that a recovery [2240] would violate the reorganization decree. Neither has any validity.

The major portion of the opinion of the Trial Court is devoted to the proposition that the "tax escape" was a fraud upon the government,[3] and therefore the proceeds were given to the defendant, an active wrongdoer.[4] This position that there was a fraud is given no support by the tax agents of the government who made the settlement.[5] It was expressly repudiated in open court by every party in this case. The majority of this Court, as the opinion shows, does not rely upon it.

A second subsidiary theory was also advanced below with little emphasis. The Trial Court said it would be inequitable to allow recovery to plaintiff because the stock of the then subsidiary owned by plaintiff was denied participation in either the assets or earnings in the reorganization proceeding. This reason is as unstable as the first.[6] The claim of plaintiff was not one against the original company, which was placed in reorganization. Everyone admits the genesis of the loss of plaintiff occurred later. Therefore, the claim would not in any event be barred by the decree of reorganization.[7] The liability to the government for taxes was not barred by that decree either. Liability for the use of plaintiff's loss long after the closure of the reorganization proceeding to obtain a benefit for defendant by compromise of the still existing tax claim could not be discharged nor affected by the decree in reorganization. The right furnished consideration for contractual liability between

[2241] plaintiff and defendant as independent corporations. Plaintiff had a property right as owner of these shares of stock.[8] The reorganization court had power to deny plaintiff participation in the assets of its subsidiary, and, as a result, all but nominal values in the shares in the subsidiary were lost. But plaintiff was not in reorganization itself.[9] The company in reorganization did not own the stock and could not legally exercise the appurtenant property right to file a consolidated return. The reorganization court had no jurisdiction of plaintiff or of these property rights.

Decree of that court attempting to destroy rights of property in the stock owned by plaintiff would be void. The reorganization decree does not deal with the property rights in the stock and is therefore res judicata neither as to plaintiff nor as to its rights of property in the shares of stock or appurtenances.

Thus the two grounds advanced to sustain the judgment fail. The cause should be reversed for failure to state adequate findings to support the judgment. Findings must be made in the Trial Court. Appellate courts have no such right or function. The majority opinion attempts to accomplish justification of the result below by drawing inferences, deductions and conclusions from evidence which they claim to find in the record. It would be possible for other judges to set up a diametrically opposite set of facts from which a judgment in favor of plaintiff might be based. The very reason that Rule 52 requires findings of fact [2242] is illustrated by the majority opinion. For the technical difficulties of finding a basis of fact for this judgment are many. Indeed, such difficulties are insurmountable.

June 27, 1946—
Institution of suit by Van Kir
United States District Court f
Holding Corp, the James Fo
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October 10, 1946—
Institution of suit by Holdin
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February 11, 1947—
Offer of settlement of tax lial
Revenue.
(By letter of James K. P
D. C.)
April 7, 1947—
Complaint in intervention by
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May 19, 1947—
Offer of settlement of tax lia
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Resolution adopted by Boar
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August 13, 1947—
Offer of settlement of tax lial
of Internal Revenue, dated F
(By letter of E. J. McLarn
August 26, 1947—
Notice of disallowance by Co
(By letter of E. J. McLarn

June 27, 1946—

Institution of suit by Van Kirk, et al., in the right of the Holding Corp and for the benefit of its stockholders, in the United States District Court for the Southern District of New York against the Reorganized Company, the directors of Holding Corp, the James Foundation, and others; seeking *inter alia* to recover the tax savings alleged to have been realized through the filing of consolidated tax returns for 1942, 1943 and the first four months of 1944.

NOTE: *The institution of this suit marks the first assertion of any claim that the Holding Corp should have been compensated for the use of its stock loss in the consolidated returns.*

October 10, 1946—

Institution of suit by Holding Corp against the Reorganized Company, et al., in the United States District Court for the Northern District of California, seeking to recover the tax savings alleged to have been realized through the filing of consolidated returns for 1942, 1943 and the first four months of 1944.

February 11, 1947—

Offer of settlement of tax liabilities for 1942, 1943 and first four months of 1944 presented to Commissioner of Internal Revenue.

(By letter of James K. Polk, Attorney-in-Fact, to Joseph D. Nunan, Jr., Commissioner of Internal Revenue, Washington, D. C.)

April 7, 1947—

Complaint in intervention by Van Kirk, et al., filed in suit of the Holding Corp against the Reorganized Company, et al. in the United States District Court for Northern District of California.

May 19, 1947—

Offer of settlement of tax liabilities for 1942, 1943 and first four months of 1944 presented to Internal Revenue Agent in Charge, New York, N. Y.

(By letter of James K. Polk, Attorney-in-Fact, to C. R. Krigbaum, Internal Revenue Agent in Charge, New York, N. Y. This offer conforms with offer in letter of February 11, 1947, supra.)

August 13, 1947—

Resolution adopted by Board of Directors of Holding Corp approving and ratifying the offer of settlement made to Commissioner of Internal Revenue on February 11, 1947, upon the condition that the Reorganized Company enter into a certain stipulation, which stipulation was subsequently executed and filed with the United States District Court.

August 13, 1947—

Offer of settlement of tax liabilities, as proposed by letter from James K. Polk to Joseph D. Nunan, Jr., Commissioner of Internal Revenue, dated February 11, 1947, accepted by Commissioner of Internal Revenue.

(By letter of E. J. McLarney, Deputy Commissioner, to The Western Pacific Railroad Corporation and Affiliated Companies.)

August 26, 1947—

Notice of disallowance by Commissioner of Internal Revenue of claims for refund of taxes for the year 1942.

(By letter of E. J. McLarney, Deputy Commissioner, to The Western Pacific Railroad Corporation.)

If recovery is to be denied, the findings of fact, upon which determination adverse to plaintiff is based, must deal with the admitted facts and the allegations of the complaints of intervenors and plaintiff. Thereby, these material claims must be negatived.

In order to indicate what findings must be made to negative plaintiff's claim, a review of various phases thereof will be made. First, plaintiff had a property right to file or refuse to file consolidated returns, which could neither be given away without consideration nor cut off judicially without due process. Second, a trust fund was apparently created to pay these taxes by the reorganization court, and no order thereof has been shown vesting this fund in defendant. Third, by stipulation with defendant, plaintiff, as trustee, deposited a trust fund in court, which has not been distributed. Fourth, as an independent corporation, plaintiff, at request of defendant, filed consolidated returns and made a settlement with the United States, from which defendant derived benefit. Therefore, plaintiff is entitled to recovery for at least as much as it was worth. Fifth, a recovery much in excess of bare compensation for doing the acts is foreshadowed. Plaintiff has not been found to be in a fiduciary capacity toward defendant, and therefore the actual cash benefit obtained by defendant by use of losses [2243] of plaintiff might well be compensated by award of an equitable portion of the tax remission which the United States allowed on account thereof. The findings made do not negative these contentions.

First then, plaintiff was found by the Trial Court to have been the owner of all the stock in the operating company when the petition for reorganization was filed. The Inter-

state Commerce Commission held that the assets of the operating company, at the initiation of the proceeding, were so shrunken that this stock was valueless for the purpose of participation in either the assets or earnings of the reorganization. The Supreme Court affirmed the denial of the petition of plaintiff for this relief. Plaintiff thereby is found to have sustained a loss of $75,000,000.00. There is no finding that the property right in the shares of stock was taken away from plaintiff either by this order or by the decree of reorganization.[10] Because of this ownership of these shares, plaintiff claims, under the recent enactment of Congress, a property right appurtenant thereto to use this loss in consolidated return and to offset it against earnings made by the properties in reorganization. Since, under the law, all corporations concerned must consent to the filing of consolidated returns, it is clear, contrary to the statement in the majority opinion, that plaintiff had no duty requiring it to file these returns. Plaintiff had a legal right to refuse to file. There is neither finding of fact that this property right did not accrue to plaintiff nor a finding that the [2244] right vested in the subsidiary, the trustees in reorganization or in defendant.

It is found that plaintiff, by contract, transferred the stock in the former subsidiary to the reorganization trustees, after the right to file consolidated returns and have the benefit of offsetting losses against operating gains by the trustees, for income tax purposes, had accrued. These shares are thus recognized as property rights. There is no finding that the right to file or refrain from filing consolidated returns was sold and transferred with the shares of stock to the reorganization trustees.

And here it might be well to deal with one specious argument. It seems to be assumed that the officers of plaintiff could give away the property right to file or refuse to file consolidated returns either voluntarily or acting under the control of defendant or the reorganization trustees. This is strange doctrine. At the time of the transfer of stock, rights of creditors of plaintiff as well as those of stockholders were involved. By the enactment of Elizabeth, an insolvent corporation cannot hinder, delay or defraud its creditors by a transfer of property in their despite.[11] The equitable considerations are stressed by the Trial Court. The Chancellors have universally held that a transfer of all the assets of corporation, at the time not insolvent, cannot be made even by a majority of the stock.[12] Neither officers nor directors, without a vote of the majority, have such power.[13] In this case, it is of stellar importance that this right of plaintiff was its sole asset and that, upon appropriation thereof, [2245] it became insolvent.[14] Specifically in any event, the transfer must be for adequate consideration and not in fraud of creditors or it will be invalid as against stockholders.[15] There are thus equitable considerations which the findings did not exclude.[16]

In a suit where stockholders of plaintiff intervene, there must be findings that there was adequate consideration for the shares of stock and the appurtenant right of filing a return. Otherwise, the District Court would be obliged to set aside the reorganization decree in order to grant relief by recapturing the assets of plaintiff improvidently given away.[17]

But a jury argument is made based upon a bare offer, which the Trial Court properly held incompetent, that the

present stockholders of plaintiff did not pay adequate value for the stock. Suffice it to say that the James interests, which are present stockholders of defendant and which will share in this windfall, apparently acquired that stock to some extent by compromise of the interests of plaintiff in the stock which it formerly held.

Second, plaintiff claims there was a trust fund created by the reorganization court in the amount of $7,100,000.00 for the payment of taxes, and that defendant added $3,000,000.00 to the fund for the same purpose. Plaintiff claims, since these funds were saved by its action in filing the consolidated returns and making a contract of settlement with the government, that it is entitled to receive some compensation for conserving the trust funds. This claim is not valid as to the fund initiated by defendant [2246] itself. A corporation has a right to set up reserves from its funds to meet contingencies. But the money impounded by the Bankruptcy Court to pay taxes was made up of funds in the hands of the reorganization trustees. There must be a finding that the Court decreed that this money should become the property of the defendant if not used to pay taxes. Otherwise, it constitutes a trust fund of undistributed assets of the reorganization.[18]

Third, plaintiff claims defendant stipulated that the $3,385,290.00 should be treated as if it had been paid to plaintiff "as agent" and the latter had placed this trust fund in court for distribution.[19] By the stipulation, plaintiff "as agent" was trustee of an express trust and, as such, had a right to deposit the fund and ask for a determination of the rights of all parties thereto, as in the nature of interpleader. Plaintiff affirmatively demanded findings upon this feature,

and the Trial Judge refused to make them. A stipulation of parties to litigation that a fund is deposited in court is sufficient. The Court must give affirmative directions that the fund be paid to the proper party.[20] Before such a judgment be entered, findings of fact are required. It is assigned as error that the Trial Judge refused to make findings on this point. The Rule requires findings of fact. This is error requiring reversal. The judgment here against plaintiff did not end the case. According to the very record before us, there is still a fund in the Trial Court which has not been distributed.

Fourth, we need not go so far afield. If we disregard [2247] control of the officers[21] of plaintiff by defendant, the ownership of the stock and the appurtenant right to file returns and the presence of a trust fund, still a cause of action was proven prima facie[22] by facts which the Trial Court did find. We need only to be sophomorical enough to remind ourselves that, where one, at the special instance and request of another, does an act and benefit accrues to the one who made the request, the legal result is so standardized that for centuries it has been stated in one of the common counts.[23] Here there were two independent corporations at the time of the settlement of tax liability. They were capable of contracting with each other. Neither was longer connected with the other. Plaintiff, at the request of defendant long after the reorganization had been closed, entered into a settlement with the United States, whereby its losses were used to obtain a benefit of $17,000,000.00 for defendant. Plaintiff was not bound to refuse consent to the filing of consolidated returns. It would seem, therefore, that sufficient facts are shown so that, in an action on the claim,

plaintiff should recover (quantum meruit)[24] as much as the service was worth. Findings as to any affirmative defense should be specific.

If defendant had emerged sufficiently from reorganization to pay its own attorneys $300,000.00 for the same service, it is difficult to see how the reorganization decree prevents defendants from compensating plaintiff at least for what the services were worth, which were rendered at its request and which resulted in benefit to it.

Fifth, it seems clear that definitive findings must [2248] be made on other phases in order to deny plaintiff a much broader recovery. An argument is made that plaintiff is a fiduciary as respects defendant. The tax statute provides that plaintiff could use its loss of $75,000,000.00 to offset the earnings of the reorganization trustees and thereby obtain a remission of taxes for the reorganized company. Without the loss to plaintiff, the statute would not have applied. Without consent of plaintiff, neither could consolidated returns have been filed nor settlement made. The tax statute does not go farther and lay down any rule for allocation of the benefits obtained from a remission of taxes. The principles of equity should control division.[25] It is said, although there are no findings that the history of prior consolidated returns is controlling.[26] Of course, it cannot probably be shown how plaintiff heretofore dealt with a consolidated return after there has been a divorce from a subsidiary. If we look at it realistically, but little question arises. If plaintiff were still the owner of the stock of defendant, then the allocation of the $17,000,000.00 to defendant would be reflected in the increased value of its stock. The transfer of the stock left the right untouched. Since increase in value

of stock in defendant no longer is of avail to plaintiff, there should be another method of applying the remission to the loss.

Finally, it may be, as the Trial Court said, that there is an overwhelming public policy which dictates that the reorganized company should be left alone as owner of the "amazing and undeserved tax" remission. But, before we, as Judges, take this [2249] sole remaining asset without compensation from stockholders of the plaintiff, who bore the losses, and give it as a surplus to distribute to the stockholders of the reorganized company, we should set out in clear and specific findings of fact the exact steps by which we accomplish such a result.

The cause should be reversed in order to permit adequate findings to be made.

(Endorsed:) Opinion and Dissenting Opinion. Filed Oct. 29, 1951. Paul P. O'Brien, Clerk.

FOOTNOTES

[1]The patent insufficiency of the findings of the lower court to support the weight of the superstructure now imposed is apparent. The order adopted the opinion as findings: "Findings of Fact. Plaintiff having proposed findings of fact in addition to the findings contained in the Court's opinion filed herein on September 6, 1949, and the defendant having objected thereto, and the Court being now satisfied that all facts necessary for decision are found in the opinion of September 6, 1949, now adopts by reference all such findings as its formal findings of fact in this cause, for all purposes as if the same were fully set forth herein. Conclusions of law. The Court concludes that the plaintiff shall take nothing herein and that the defendants shall have judgment in their favor for their costs of suit." Rule 52, Federal Rules of Civil Procedure; 28 U.S.C.A. § 2106; Interstate Circuit vs. United States, 304 U.S. 55, 56; Kelley vs. Everglades District, 319 U.S. 415, 420, 421.

[2]The opinion of September 6, 1949, thus referred to, appears in 85 F. Supp. 868. Insufficiency of findings appears in important particulars indicated below.

[2250] There are no findings as to the mechanics of use of the right of plaintiff. It is not shown whether any resolutions were passed by the Board of Directors or stockholders of plaintiff authorizing the use for benefit of defendant. There is no finding whether a gift of the right was intended or whether there was an attempted payment of consideration.

There is no finding that plaintiff was ever party to the reorganization proceeding. There is no finding that plaintiff had any connection with the proceeding except to prosecute a claim for value of stock, which was disallowed.

There is no finding that the compromise settlement with the government, in which plaintiff participated and from which benefit to defendant arose, was connected with or contemporaneous with the reorganization proceeding.

The court should have found that defendant honestly believed that it was rightfully entitled to use the loss of plaintiff without consulting those beneficially interested in plaintiff or it used the loss fraudulently in deliberate disregard of the rights of those beneficially interested in plaintiff. The court should have found whether defendant was guilty either of mistake or of fraud. The belief of defendant's officers as to its rights at the time of filing the consolidated returns is one of the key facts in the case and should have been the subject of findings.

[3]The rationale of the opinion is set forth in colorful language. 85 F. Supp. 868, 875: "An array of able counsel on both sides have put forth prodigious and ingenious efforts, one side to retain the benefits of the tax 'escape', and the other to obtain them. And all the time the taxes escaped in reality belong to the United States! The Court cannot cause these taxes to be paid, where they should be paid, to the United States."

[4]Even if the transaction were illegal, the result reached by the Trial Court could not stand. Cf. Barney vs. Saunders, 57 U.S. 534, 543: "They cannot be allowed to aver that the profits made on the [2251] trust funds should be put in their own pockets, because they were unlawful gains, for fear that the conscience of the cestui que trust should be defiled by participation in them. To indulge trustees in such an obliquity of conscience, would be hold-

ing out immunity for misconduct and an inducement to speculate with the trust funds, and put them in peril."

[5]The fact that the agents of the Government, who effected the settlement, did not agree that there was a fraud on the United States is shown by United States ex rel. S. Roberts vs. The Western Pacific Railroad, 9 Cir., No. 12,723, June 15, 1951.

[6]The error of the lower court was in assuming that plaintiff is seeking an interest in the defendant corporation instead of compensation for property taken by defendant which belonged to plaintiff. The Trial Court made no finding as to the nature of the right to file consolidated returns, which only plaintiff could exercise (Reg. 104, § 23.16(a)), but which it could refuse to exercise (Reg. 104, § 23.11(a)). Until such findings are made, there is no basis for a judgment denying participation in benefit.

[7]The effect of the decree is provided by 11 U.S.C.A. § 205(f), Tilt vs. Kelsey, 207 U.S. 43, 52. Since the tax settlement between the government and the corporation occurred after the decree in reorganization, there could be no res judicata. Commissioner vs. Sunnen, 333 U.S. 591, 597, et seq.; Diaz vs. United States, 223 U.S. 442, 449.

[8]An incontrovertible proof of the proposition that plaintiff had no duty to apply the loss for the benefit of defendant may be cited. If plaintiff had sold a gold mine for a profit of over $75,000,000.00, its loss on the stock of the subsidiary could have been applied to offset any taxes against plaintiff. In that event, the trustees in reorganization would have been required to pay taxes against the operating company. Once used, the power of applying the loss would be functus officii, and plaintiff would have received the entire benefit.

[2252] [9]Callaway vs. Benton, 336 U.S. 132. The error in this proceeding, therefore, was the failure to reorganize plaintiff also. An illustrative case, where the parent was in reorganization, is reported in a series of opinions as In re Portland Electric Power Co., 97 F.Supp. 857-921. There a consolidated return was filed during the proceedings and the benefits appropriately distributed.

[10]It is inconceivable that a decree of reorganization prevents the company, when released from tutelage, from entering engagements and incurring liabilities. Otherwise, the reorganization would be perpetual. See In re Portland Electric Power Co., 97 F.Supp. 857, 873.

[11]Act of 1571, 13 Eliz. c. 5; Glenn, Fraudulent Conveyances and Preferences (Rev. Ed. 1940), §§ 61 d, e, Vol. I, pp. 95-99.

[12]Des Moines Life & Annuity Co. vs. Midland Insurance Co., 6 F.2d 228. The statutes carry out the principle with various limitations. As plaintiff is a Delaware corporation, see Del. Rev. Code (1935) § 65.

[13]Fletcher, Cyclopedia of the Law of Private Corporations (Perm. Ed.) § 1107.

[14]The trust fund theory probably applies. See Fletcher, Cyclopedia of the Law of Private Corporations (Perm. Ed.) § 7371.

[15]Fletcher, Cyclopedia of the Law of Private Corporations (Perm. Ed.) § 2946, notes 99 and 1.

[16]An interesting case in this Court, where the subsidiary was held liable for the unauthorized transfer of property of the parent by an officer of the subsidiary, is Clark & Wilson Lumber Company vs. McAllister, 101 F.2d 709.

[17]Since plaintiff is a Delaware corporation, the decisions of that state are cited as illustrative of the general principle. Robinson vs. Pittsburg Oil Refining Corporation, 14 Del. Ch. 193, 199; Hutton vs. [2253] West Cork Railway Company, 23 L.R. Chancery Div. (1883) 654, 671, 677; Revised Code of Delaware (1935), Ch. 65, § 65, Ch. 174. Cf. Laws of Delaware (1941), Ch. 132, § 1.

[18]The Court below, the United States District Court for the Northern District of California, Southern Division, was the reorganization court. 34 F.Supp. 493. It therefore had the power to set aside the decree in reorganization, 11 U.S.C.A. §§ 11(8), 205(1), and administer this unadministered asset. Incidentally, the defendant cannot escape under any theory since it is under bond to pay all claims against the trustees.

[19]The stipulation of the parties was that a fund was paid into Court by plaintiff and therefore it must be returned to plaintiff's possession, unless some affirmative proof showed defendant was entitled thereto. The Trial Court held: "But, as between the parties, no persuasion of conscience or equity impels me to do otherwise than to leave the parties where they are, the defendant with its amazing and undeserved tax success; the plaintiff as the reorganization left it, without interest in the debtor." Instead of restor-

ing the parties to status quo ante, the Trial Court affirmatively awarded this to defendant. But no findings to sustain affirmative award are present.

[20]Rule 67, Federal Rules of Civil Procedure; 28 U.S.C.A. §§ 2041, 2042; Georgia vs. Madrazo, 26 U.S. 110, 121; United States vs. Morgan, 307 U.S. 183, 193; Osborn vs. United States, 91 U.S. 474, 479.

[21]As to the nature of the confidential relationship involved, where corporations have officers in common, see cases collected in annotation in 114 A.L.R. 299.

"It [a constructive trust] arises where one person acquires title to property from another by an abuse of a fiduciary or confidential relation between them * * *." Restatement of Restitution, § 166, Comment [2254] d. 3 Scott on Trusts, § 648, p. 2336. Johnson vs. Umsted, 8 Cir. (1933) 64 F.2d 316; Johnson vs. Clark, 7 California 2d 529, 61 P.2d 767 (1936); Duncan vs. Dozey, 318 Illinois 500, 149 N.E. 495 (1925); Theis vs. Vonderheyden, 94 N.J.Eq. 317, 807, 119 Atl. 502, 121 Atl. 927 (1922).

[22]Other grounds for constructive trust, which it is possible for the trier of the fact to find upon the basis of evidence in the record, are fraud (Restatement of Restitution, § 166, Comment b; Templeton vs. Hollinshead, 119 Oregon 620, 250 P. 747), mistake (Restatement of Restitution, §§ 49, 170; 3 Scott on Trusts, § 468), and conversion or misappropriation (Burke Grain Co. vs. St. Paul Mercury Indemnity Co., 8 Cir., 94 F.2d 458; Pioneer Mining Co. vs. Tyberg, 9 Cir., 215 F. 501). As noted in the text following, a trust need not be worked out in all probability since simpler theories may serve for recovery.

[23]Matarese vs. Moore McCormack Lines, 2 Cir., 158 F.2d 631, 170 A.L.R. 440 and note; Corbin on Contracts, § 1112; 1 Williston on Contracts, § 41, p. 115; Costigan, Implied in Fact Contracts and Mutual Assent, 33 Harv. L.R. 376; Burton vs. Burton Stock Car Co. (1898), 171 Massachusetts 437, 50 N.E. 1029; Ft. Wayne C. & L.R. Co. vs. Haberkorn (1896), 15 Indiana App. 479, 44 N.E. 322.

[24]Assumpsit would lie even though the Trial Court made findings of misappropriation, embezzlement and conversion. Reynolds vs. New York Trust Co., 188 F. 611; Terry vs. Munger (1890), 121 New York 161, 24 N.E. 272, 8 L.R.A. 216, 18 Am. St. Rep. 803; Conaway vs. Pepper (1919), 7 Boyce 511, 108 Atl. 676; Roberts

vs. Evans (1872), 43 California 380; consult annotation 97 A.L.R. 250 and text treatment 1 C.J.S. Actions § 50(b).

[25]Restatement, Restitution, §§ 1, 81; Phillips-Jones Corporation vs. Parmley, 302 U.S. 233.

[26]See Note 8, supra.

III. Per Curiam Opinion of January 30, 1952, on Appellants' Petitions for Rehearing in the United States Court of Appeals for the Ninth Circuit.

[2260] *United States Court of Appeals for the Ninth Circuit*

[Title of Cause.]

Jan. 30, 1952

On Appellants' Petitions for Rehearing

Before: Healy, Circuit Judge,
Fee and Byrne, District Judges.

Per Curiam

The petitions of the appellants and intervenors for a rehearing are denied. Insofar as the petitions seek a rehearing en banc, they are stricken as being without authority in law or in the rules or practice of the court. See Kronberg v. Hale, 9 Cir., 181 F. 2d 767.

[Endorsed] Order. Filed January 30, 1952.

Paul P. O'Brien, Clerk.

IV. Dissenting Opinion of February 18, 1952, of Judge James Alger Fee on Appellants' Petitions for Rehearing in the United States Court of Appeals for the Ninth Circuit.

[2261] *United States Court of Appeals for the Ninth Circuit*

[Title of Cause.]

Feb. 18, 1952

On Appellants' Petitions for Rehearing

Before: Healy, Circuit Judge, and
Fee and Byrne, District Judges.

James Alger Fee, District Judge, (dissenting and suggesting a rehearing en banc of all Circuit Judges):

This cause involves the disposition of over $21,000,000.00. The solution requires application of novel statutory language affecting the fields of bankruptcy and taxes. I have expressed myself heretofore and still feel that the findings of the lower court do not support the determination made by two judges on the panel here.

I am unable to agree with either the denial of rehearing or the striking of the petitions which ask for a rehearing by the full complement of Circuit Judges of this Court en banc. Two District Judges and one Circuit Judge constituted the panel which heard the case. As has been pointed out in this serious and important litigation, three District Judges have, respectively, expressed three widely divergent views, while no member of the Court of Appeals has written a line on the merits.

[2262] I therefore suggest to the Court of Appeals a rehearing en banc of all the Circuit Judges. For this there is precedent in this Circuit.[1] The practice as I understand it, substantially accords with that of the Third Circuit,[2] which is admirable. Inasmuch as this might be the court of last resort in this case, it seems fairer to have the issues disposed of by Circuit Judges.

The Supreme Court of the United States at least once has given permission to an appellant to apply to this court for a hearing en banc. 316 U. S. 649.[3] In taking that action, reference was made to Textile Mills Securities Corporation vs. Commissioner of Internal Revenue, 314 U.S. 326.

[Endorsed]: Filed February 18, 1952. Paul P. O'Brien, Clerk.

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[1]Judges Denman, Matthews and Stephens sat in Hopper vs. United States, 9 Cir., 142 F. 2d 167, and Judges Wilbur, Denman and Healy sat in Crutchfield vs. United States, 9 Cir., 142 F. 2d 170. At page 177 of 142 F. 2d appears Circuit Judge William Denman's motion for a rehearing en banc of the Hopper case, supra, wherein it is stated that the cause is "now pending for rehearing in this Court." Accordingly, the rehearing of that case was held en banc before Judges Wilbur, Garrecht, Denman, Matthews, Stephens and Healy, being all of the Circuit Judges of this Court. Hopper vs. United States, 9 Cir., 142 F. 2d 181.

[2]United States vs. Gallagher, 3 Cir., 183 F. 2d 342, was heard by a panel of two Circuit Judges and one District Judge, and, upon suggestion of one of the Judges, was heard en banc by all Circuit Judges.

[3]See Robinson vs. Johnston, 9 Cir., 130 F. 2d 202.

V. Opinion and Dissenting Opinion of July 9, 1952, in Re Petition to File Motion to Vacate Order, etc. in the United States Court of Appeals for the Ninth Circuit.

[2288] *United States Court of Appeals for the Ninth Circuit*

[Title of Cause.]

IN RE PETITION OF WESTERN PACIFIC RAILROAD CORPORATION FOR LEAVE TO FILE A MOTION DENOMINATED "MOTION TO VACATE ORDER STRIKING APPELLANT'S PETITION FOR REHEARING EN BANC AND REINSTATING SUCH PETITION."

Before: DENMAN, MATHEWS, STEPHENS, HEALY, BONE, ORR, and POPE, Circuit Judges

HEALY, Circuit Judge.

OPINION

Case No. 12,506, supra, upon its coming at issue in this court, was regularly assigned for hearing and [2289] determination to a court or division of three judges comprising Circuit Judge Healy and District Judges Fee and Byrne. Subsequent to argument and submission of the case the court handed down an opinion and order affirming the judgment of the district court, Judge Fee dissenting. —— F. 2d ——. Thereafter the appellants petitioned for "rehearing and rehearing en banc," and the court on January 30, 1952, denied the petition, Judge Fee again dissenting. —— F. 2d ——. Insofar as the petition sought a rehearing in banc it was ordered stricken as unauthorized by law or practice.

On March 10, 1952, the Western Pacific Corporation presented the petition for leave described in the caption. In its supporting brief it asserts that it is its right under the law to have its petition for rehearing considered and acted upon by all the circuit judges. On order of a majority of the circuit judges, the court has been assembled in banc for the purpose of announcing the principles of law and practice it deems applicable in respect of in banc hearings. This course is thought appropriate in order that litigants and the bar may be advised not only of the position taken by the court but of the reasons for it.[1]

[2290] The governing statutory provision, 28 USCA § 46(c), reads:

> "(c) Cases and controversies shall be heard and determined by a court or division of not more than three judges, unless a hearing or rehearing before the court in banc is ordered by a majority of the circuit judges of the circuit who are in active service. A court

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[1]In recent years it has become the custom of counsel almost as a matter of course to petition the full membership of the court for a rehearing in banc, upon suffering an adverse decision at the hands of a court of three judges. This hopeful concept of the right of litigants appears to stem from declarations in the dissenting opinion in Independence Lead Mines v. Kingsbury (1949), 9 Cir., 175 F. 2d 983, at p. 992, cert. den. 338 U. S. 900, to the effect that two judges in a court or division of three are without authority to pass upon or deny a petition for rehearing addressed to all the circuit judges.

The numerous petitions of this nature have been disposed of by the court or division concerned either (1) by ignoring the application for in banc action and treating the petitions simply as ordinary petitions for rehearing, or (2) by striking them insofar as they sought in banc action. The treatment has not in the least served to discourage losing counsel or to stem the growing tide of such petitions.

in banc shall consist of all active circuit judges of the circuit."[2]

The obvious intendment of this statute is to perpetuate the United States Courts of Appeals as courts of three judges in all cases save those in which an in banc hearing is ordered by all or a majority of the circuit judges. No doubt Congress was [2291] fully alive to the fact that these courts, despite the increase in their membership, would be unable to keep abreast of the constantly growing volume of judicial business unless they continued in all normal circumstances to function as courts of three.

Important light will be shed on the problem under inquiry if we examine the method pursued in the assignment of cases, as prescribed by our Rule 4.[3] In practice the cal-

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[2]The section was enacted as part of the 1948 Judicial Code revision. In its entirety it reads as follows:

"46. Assignment of judges; divisions; hearings; quorum

(a) Circuit judges shall sit on the court and its divisions in such order and at such times as the court directs.

(b) In each circuit the court may authorize the hearing and determination of cases and controversies by separate divisions, each consisting of three judges. Such divisions shall sit at the times and places and hear the cases and controversies assigned as the court directs.

(c) Cases and controversies shall be heard and determined by a court or division of not more than three judges, unless a hearing or rehearing before the court in banc is ordered by a majority of the circuit judges of the circuit who are in active service. A court in banc shall consist of all active circuit judges of the circuit.

(d) A majority of the number of judges authorized to constitute a court or division thereof, as provided in paragraph (c), shall constitute a quorum."

[3]Rule 4, subdivisions 1 and 2, reads:

"ASSIGNING OF CAUSES FOR HEARING

"1. The calendars of the court shall be made up by the Clerk

endars for the court are tentatively made up by the chief judge in collaboration [2292] with the clerk. On these calendars each case is assigned for hearing and determination to a court or division of three named judges, unless it has been otherwise ordered. The proposed calendar is circulated among all the judges, and any designation or assignment may be modified or set aside by a majority. When the calendar is approved by the judges their action is uniformly manifested by their initialing the same, as is done in the case of court orders generally. Thus the calendar as finally adopted evidences or necessarily implies at least the tentative determination of the judges that the cases assigned to courts of three are not of such character as to warrant their being heard before the court in banc. In the instances in which at the time of assignment it is agreed by all or a majority of the judges that a particular case should be heard and determined in banc, it is calendared as such.[4] It [2293]

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under the direction of the Chief Judge subject to the approval of the majority of the judges.

2. The Chief Judge after conference with the Circuit Judges shall designate and assign the judges who are to hear the causes placed upon the calendars of the court; such designation or assignment may be modified or set aside by a majority of the judges."

[4]Since the decision in Textile Mills v. Commissioner, 314 U. S. 326 (1941) approximately thirty cases in all have been heard in banc in this circuit. Nineteen of these, or about two-thirds of the whole, were assigned to the court in banc at the time they were originally calendared. Perhaps more than half of the nineteen were cases of great public consequence, such, for example, as those growing out of the suspension during the war of the writ of habeas corpus and the institution of martial law in Hawaii, or cases involving the forcible removal of the Japanese from the Pacific Coast states. Others were contempt matters involving claimed

sometimes occurs, too, that examination of a case preliminary to hearing, or consideration of it after argument, leads the judges to whom it was assigned to conclude that it is an appropriate cause for in banc consideration, and they so indicate to the remaining judges. If the latter or a majority of all agree, the case is then reassigned for hearing by all the judges.[5]

If we examine the status of Case No. 12,506 in the light of this practice, it becomes apparent that it was calendared and heard by court order as one in which in banc consideration was not deemed requisite. There remains to inquire whether the losing party in the cause is at this juncture entitled as of right to have its petition for rehearing considered and ruled upon by a court composed of all the circuit judges.

The statute, it will be recalled, commits to a "court or division of three judges" the power to *hear* and *determine* the cases and controversies assigned to it. Obviously its determination of any such case or controversy is a decision of the Court of Appeals, and as such is a final decision, subject to review only as prescribed by 28 USCA § 1254. Circuit judges other than those designated to sit on such

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violations of the constitutional prohibition against self-incrimination.

There are no definite criteria that we know of by which to determine what cases are suitable for in banc consideration. However, causes of extraordinary public importance or those involving constitutional questions probably belong in the category.

[5]McCoy v. United States, 9 Cir., 169 F. 2d 776; Samuel v. United States, 9 Cir., 169 F. 2d 787; Tee Hit Ton Tribe v. Olson, 9 Cir., 160 F. 2d 525; Los Angeles Building & Construction Trades Council v. LeBaron, 9 Cir., 185 F. 2d 405; Price v. Johnston, 9 Cir., 159 F. 2d 234, 161 F. 2d 705.

court or division are not members of it, and officially they play, and are entitled to play, no part in its deliberations at [2294] any stage. That this is so is made clear by subdivision (a) of § 46 (see Note 2 above) providing that "Circuit judges shall sit on the court and its divisions in such order and at such times as the court directs." If regard be had for this mandate circuit judges may not intrude themselves, or be compelled on petition of a losing party to intrude, upon a court or division on which they have not by order of the court been directed to sit.

A petition for rehearing in any such case, whatever its form or wording, must necessarily be treated as addressed to and is solely for disposition by the court or division to which the case was assigned for determination. If the court so constituted, or a majority of its members, denies the petition, that ends the matter so far as concerns the Court of Appeals. If it grants a rehearing it may follow either of two courses: (a) it may, and in all ordinary situations does, rehear the case itself; or (b) it may for reasons thought adequate suggest to the nonparticipating judges that the case is one which ought to be reheard in banc; and if all or a majority of the circuit judges agree, the case is then placed on the calendar for in banc consideration.[6]

[2295] Adoption of the view currently being urged would render merely tentative or provisional the decisions of the

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[6]This was the course followed in Hopper v. United States, 9 Cir., 142 F. 2d 181; Southern Pacific Co. v. Guthrie, 9 Cir., 180 F. 2d 295, 186 F. 2d 926; Evaporated Milk Ass'n v. Roche, 130 F. 2d 843; and Pacific Gas & Electric Co. v. SEC, 139 F. 2d 298. In the **Hopper** case, supra, and to a lesser degree in Southern Pacific v. Guthrie, intracircuit conflicts were resolved. The other two cases cited in this note were nondescript matters.

court in 98 per cent or more of the cases that come before it. On petition of a dissatisfied party its decisions would automatically be subject to a species of horizontal appeal which would completely nullify the prime statutory objective of effecting a division of the court's work. The judges other than those to whom the cases had been assigned would perforce be required to acquaint themselves with the issues and problems involved in the same painstaking manner as did their associates who had heard and determined the causes initially, and this without the latter's advantage of having heard oral argument. Obviously, unless he is prepared to stultify himself, no judge would undertake to rule upon petitions for rehearing without adequate and full study and investigation of the merits.

On these considerations and in harmony with its understanding of the statutory scheme, the court has consistently retained to itself as a matter of administrative and intramural concern only the problem whether or not any given case should be heard or reheard in banc. Accordingly, in the exercise of its uncontrolled discretion the court has declined altogether to entertain petitions of litigants for such hearings. The position it takes is that, apart from the possible disqualification of a judge, the composition of the court to which a case may be assigned for determination is a matter wholly outside the province of the parties.

It has been remarked by some commentators that [2296] the procedure outlined by Congress for the Courts of Appeals involves a distinct hazard of intracircuit conflicts. The hazard, we think, may easily be overestimated. It is minimized by the alertness of counsel and by informal and unofficial interchanges among the judges. Where conflicts

occur they are capable of remedy by in banc action without wholesale duplication of effort, as our own practice and experience have demonstrated.

The petition for rehearing in this cause has already been authoritatively denied by the division to which the cause was assigned. The petition for leave to file, addressed to the court in banc, is denied.

From this time forward petitions, if any, for rehearing in banc in cases determined by divisions of three judges will be considered and disposed of by the latter as ordinary petitions for rehearing.

DENMAN, Chief Judge, dissenting from the court's holding that the circuit judges not participating in a division, here six of the seven such judges, (a) are without power to consider a litigant's petition for a rehearing en banc, and (b) where a rehearing or rehearing en banc has been denied by a division, are without power to vote to grant a rehearing en banc, if two of the division's judges, here with but one circuit judge, do not desire such a rehearing. This appears from the following language of the opinion:

> "A petition for rehearing in any such case, whatever its form or wording, *must necessarily*[1] be [2297] treated as addressed to and is *solely* for disposition by the court or division to which the case was assigned for determination. If the court *so constituted,* or a majority of its members, denies the petition, *that ends the matter so far as concerns the Court of Appeals.* If it grants a rehearing it may follow either of two courses: (a) it may, and in all ordinary situations does, rehear the case itself; or (b) it may for reasons thought ade-

[1]Emphasis hereafter appearing in quoted matter is supplied.

quate *suggest to the nonparticipating judges that the case is one which ought to be reheard in banc;* and if all or a majority of the circuit judges agree, the case is then placed on the calendar for in banc consideration."

* * * *

"The statute, it will be recalled, commits to a 'court or division of three judges' the power to *hear* and *determine* the cases and controversies assigned to it. Obviously *its* determination of any such case or controversy is a decision of the Court of Appeals, and as such is a *final decision, subject to review ONLY as prescribed by 28 U.S.C. § 1254."* Thus squarely is denied the power of the court en banc to review a division's decision in a "rehearing en banc . . . ordered by a majority of the circuit judges." See 28 U.S.C. 46(c).

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"From this time forward petitions, if any, for rehearing in banc in cases determined by divisions of three judges will be considered and disposed of by the latter as ordinary petitions for rehearing."

In this case the Western Pacific Railroad Corporation, hereafter the Corporation, petitions the [2298] Court en banc for leave to file a petition for a rehearing en banc. The latter seeks to establish, inter alia, that the judgment of the division which heard the case decided the main issue therein contrary to the decision of a prior division of this court.

The division in the instant case, consisting of one circuit judge and two district judges, has ordered "stricken" a petition addressed to the seven judges constituting the court en banc. This order follows a precedent of similar strikings of petitions for rehearings en banc in the cases of Kronberg v. Hale, 181 F.2d 767 (Cir. 9), Fruehauf Trailer v. Myers,

181 F.2d 1008 (Cir. 9), Northwestern Mut. Ins. Co. v. Gilbert, 182 F.2d 256 (Cir. 9).

Since Kronberg v. Hale, the Clerk has distributed no petitions for rehearings en banc to the non-participating circuit judges. From a casual remark of counsel in a social contact, I learned of the Corporation's instant petition and instructed the Clerk to distribute it to the six circuit judges not sitting in the division. But for this casual discovery and my suggestion that the stature and determination of the Corporation's counsel made it likely they would seek mandamus in the Supreme Court, the petition would have had the "striking" treatment of the above cases.

The court's opinion came after a conference originally called for the consideration of the adoption of the rule considered last in this dissent, which would have made the burden of such petitions one we easily could bear.

[2299] A. *The court's decision violates (as well as ignores) the Supreme Court's decision in United States ex rel. Robinson v. Johnston, 316 U.S. 649, 650, a decision aimed to settle differences in the circuit's divisions.*

The case of Textile Mills Corp. v. Commissioner, 314 U.S. 326, held that notwithstanding the three-judge provision of section 212 of title 28, U.S.C., 1940 ed., a court of appeals might lawfully consist of a greater number of judges, and that the five active circuit judges of the third circuit might sit in banc for the determination of an appeal.

The Third Circuit in C.I.R. v. Textile Mills Corp., 117 F.2d 62 at page 70, in holding that its five circuit judges could sit en banc, states that otherwise they would not have

the power to correct differing views of the judges in the divisions of the court such as the Supreme Court describes as occurring in the Fifth Circuit in John Hancock Ins. Co. v. Bartels, 308 U.S. 180, 181.[2]

The Supreme Court in its Textile Mills case at page 334 in affirming the Third Circuit and overruling our decision in Lang's Estate v. C.I.R., 97 F.2d 867, 869, where we held we could not sit en banc [2300] where two divisions of the court differed as to the law controlling, states of rehearings en banc[3] that:

> . . . "Certainly, the result reached makes for more effective judicial administration. Conflicts within a circuit will be avoided. Finality of decision in the circuit courts of appeal will be promoted. Those considerations are especially important in view of the fact that

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[2]Following this the Textile Mills case states at page 71:

. . . "Where, however, there is a difference in view among the judges upon a question of fundamental importance, and especially in a case where two of the three judges sitting in a case may have a view contrary to that of the other three judges of the court, it is advisable that the whole court have the opportunity, if it thinks it necessary, to hear and decide the question . . ."

[3]What is said of the need of rehearings en banc for the then Third Circuit applies a fortiori today to the Ninth Circuit. The Third Circuit in the 1941 fiscal year had but five judges and 285 docketings. The Ninth Circuit has had an increase in population of six million in twelve years. In the fiscal year 1952 it had 446 docketings. On the national average of docketings for circuit judges the Ninth Circuit should have ten judges. It has seven judges but the Senate has passed a bill increasing the judgeships to nine and the House Judiciary Committee has agreed they are needed. No doubt within a year we will have nine judges with three divisions sitting simultaneously. That is to say, we have 56% more docketings and will have almost half again the number of divisions in which exist the hazard of conflicting decision referred to in the Textile Mills decisions.

in our federal judicial system these courts are the courts of last resort in the run of ordinary cases . . .''

In enacting 28 U.S.C. § 46(c) Congress codified the Textile Mills decision, the Reviser's Notes stating that that section ''preserves the interpretation established by the Textile Mills case.''

Prior to this codification of the Textile Mills decision, there was decided by one division of this circuit the case of Robinson v. Johnston, 118 F.2d 998, [2301] and later in a division of three other judges, the case of Crockett v. United States, 125 F.2d 547. The two divisions differed on the controlling law. Certiorari was sought in the Robinson case before the Crockett case was decided and it was denied. A petition for rehearing in the Supreme Court was denied. The Crockett case was then called to the attention of the court in a second petition for rehearing which was granted. The order denying the petition for certiorari was set aside and the writ of certiorari granted. Certainly this action of the Supreme Court was purposeful and deliberate.

In granting certiorari the Supreme Court in United States ex rel. Robinson v. Johnston, 316 U.S. 649, held it was the duty of this court en banc to entertain a petition for leave to file a petition for rehearing en banc, for it vacated our judgment and remanded the case to us, stating:

> ''. . . In view of the conflict of views which has arisen among the judges of the Ninth Circuit with respect to the decision in this case (see Robinson v. Johnston, 118 F.2d 998, 1001, and Crockett v. United States, 125 F.2d 547, 548, 549), and in view of this Court's decision in Waley v. Johnston, ante, p. 101, reversing 124 F.2d 587, the judgment is vacated, and the case is remanded to the Circuit Court of Appeals for further proceed-

ings, including *leave* to petitioner to apply for a hearing before the court *en banc*. See Textile Mills Corp. v. Commissioner, 314 U.S. 326 . . ."

The Corporation strongly urges the above contentions in its denied petition, all of which is ignored [2302] in this court's opinion. Instead it is said of the seeking of the leave to file the petition, that consideration of such action by any of the circuit judges not in the division (here six) would be "to *intrude* upon a . . . division on which they have not by order of the court been directed to sit."

How absurd it was, one must conclude, for the Supreme Court to order such an intrusion in Robinson v. Johnston!

B. *The Cavalier Refusal of the Court to Consider the Contentions of the Corporation's Petition.*

The shabby treatment of the litigant and his counsel in refusing to consider their contentions and authorities comes after the court's claim that its opinion gives consideration to "*the principles of law * * * which it deems applicable to en banc hearings.*"

No self respecting federal judge sleeps comfortably if he is conscious of having rendered an opinion deciding a case in which he has *purposely* failed to consider a substantial contention supported by authorities submitted to him and by such evasion has based his decision on a ground directly opposed to the evaded contention.

A possible explanation for the silent treatment of the litigant's contention and authorities in this case is that Robinson v. Johnston was deemed irrelevant because decided before the codification of the Textile Mills case in 28 U.S.C. § 46(c). That seems absurd, however, for the Su-

preme Court's construction of a law before its exact codification, as here, [2303] is applicable after codification. Otherwise, why in 28 United States Code Annotated are there the thousands of citations in sections of the Judicial Code, enacted in 1948, which codifies the then law and statutes?

C. *The Opinion's Absurd Misstatements Respecting the Assignment of Cases to the Court's Divisions.*

The opinion states:

> "... Thus the calendar as finally adopted *evidences* or necessarily implies at least the *tentative predetermination* of the judges that the cases assigned to courts of three are not of such character as to warrant their being heard before the court in banc..."

The Supreme Court in the Textile Mills case has established a definite criterion for the rehearings en banc provided for in 28 U.S.C. § 46(c). It is the only one there stated, though there are others. It is that conflicts of law between the decisions of two of the court's divisions are cause for rehearing en banc. By clearing the law en banc, the circuit does so for the 96.3% of litigation in which this court's decisions are final.

Such en banc action prevents the burden on the Supreme Court, such as in the certification of the question of such differing divisions in Lang's Estate v. C.I.R., 97 F.2d 867, 869, a burden the Supreme Court later refused to assume in its return of Robinson v. Johnston for our en banc consideration of our divisions' divergencies.

[2304] It is almost a rude question to ask, "How, in heaven's name, are the seven judges en banc to know tenta-

tively or otherwise that the division to which they assign the case will thereafter decide it without conflict with a prior decision of a different division"? The phrase, "How, in heaven's name," is used advisedly, for our tentative decision would require divine omniscience.

The opinion states that another criterion is whether the case to be assigned to a division is "one involving constitutional questions."

The slightest reflection shows that the court en banc could make its tentative assignment of a case to a division because *not* involving a constitutional question only by examination of all the briefs in all the cases to be assigned to determine whether such a constitutional contention is at issue.

Were this truly what we have done, it would have involved a volume of judicial effort comparable to that the court's opinion seeks to avoid with petitions for rehearings en banc.

In the eleven years since the Textile Mills case, the Clerk advises, we have assigned to division over two thousand two hundred cases. In but nineteen cases, less than one per cent, have they been assigned to the court en banc. These were cases whose extraordinary importance had wide newspaper notoriety. In *none* of the remaining two thousand two hundred cases has the court en banc assigned them to division after an examination of the briefs for that purpose.

[2305] D. *Further to avoid considering the corporation's contention and authorities, the opinion misstates the source of the contention that rehearings en banc are needed to cure the divergence of divisions.*

On the source of this contention the court's opinion states, "It has been remarked by *some commentators* that the procedure outlined by Congress for the Courts of Appeals involves a distinct hazard of intracircuit conflicts."

"Some commentators"! To what extent will the court go in order to avoid mentioning that this hazard was stated first by the Third Circuit in the Textile Mills case and on its appeal by the Supreme Court, and later implicitly by the Supreme Court in returning Robinson v. Johnston to this court because of the difference in viewpoint of our divisions. That is to say, in such holdings on the criterion of divergence, the Third Circuit and the Supreme Court are no more than mere commentators.

The opinion seeks to minimize the likelihood of a division overruling sub silentio a prior division's holding and this with the certainty of nine judges and three divisions in the near future.[4] The idea is that the judges in the division so acting, "by *in*formal and unofficial interchanges" with the nonparticipating judges, will advise the latter that the decision is at variance with that of a prior division. In my seventeen years on the bench I have had no associate so confess his mistaken act.

An examination of the three cases cited, supra, the Kronberg, Fruehauf Trailer and Northwestern [2306] Mutual cases, in which the petitions for rehearing en banc were

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[4]See footnote 3, supra.

stricken, shows that two of them were founded on such conflict of divisions and the third on conflicts in district court decisions on important matters. Also in the seven cases of Bradley Mining Co. v. Boice, 12684; Acheson v. United States, 12772; Independence Lead Mines Co. v. Kingsbury, 11959; Tanimura v. United States, 13014; California v. United States, 12184; Sunbeam Lighting Co. v. Sunbeam Corp., 12357, and Zamlock v. United States, 12753, the division judges refused consideration of the petition addressed to the seven and thus prevented the court en banc from considering the contention in each that the division's decision conflicted with the decision of a prior division.

E. *The court's confessed fear of the burden of an overwhelming volume of such petitions may be avoided by an amendment of its rules.*

Against a flood of such petitions we can protect ourselves, as has the Supreme Court, by amending our Rule 25 as follows:

"Rule 25.

REHEARING

"A petition for rehearing of a decision by a division of the court may be presented within 30 days after judgment. It must be printed, and briefly and distinctly state its grounds, and be supported by certificate of counsel that in his judgment it is well founded and that it is not interposed for delay. Twenty printed copies must be filed with the clerk of this court.

[2307] "Where there has been a denial of a rehearing of a decision by a division, a petition for a rehearing in bank may be filed within fifteen days. The petition shall be in the form above described and with the

same certificate of counsel. No petition will be entertained, unless one of the judges participating in that decision shall join in seeking such rehearing."

The Supreme Court has similarly protected itself on its petitions for rehearing by a provision in its Rule 33, of which the pertinent portion is:

"Such a petition . . . will not be granted unless a justice who concurred in the judgment desires it and a majority of the Court so determines."

In the last seven years there have been but 75 dissents, an average of less than 11 per year. Probably less than 11 judges per year would join in petitioning for a rehearing en banc.

In view of our prospective three divisions and the likely need for such rehearings en banc, an average of eleven such petitions would not be an intolerable burden, less than 4% of our submitted cases. It would substantially reduce the likelihood of conflict between the divisions.

By requiring first a rehearing by the division, the district judges would not be barred from the reconsideration of a decision.

The motion to file should have been considered on its merits and granted.

(Endorsed:) Opinion and Dissenting Opinion. Filed. Jul. 9, 1952. Paul P. O'Brien, Clerk.

VI. Supplement of September 11, 1952, to Dissenting Opinion of Chief Judge Denman in the United States Court of Appeals for the Ninth Circuit.

[2313] *United States Court of Appeals for the Ninth Circuit*

[Title of Cause.]

Sept. 11, 1952

SUPPLEMENT TO DISSENTING OPINION OF CHIEF JUDGE DENMAN, FILED HEREIN ON JULY 9, 1952

Since the writing of my dissenting opinion herein I have been advised by Chief Judge Harold M. Stephens of the United States Court of Appeals for the District of Columbia that that court has rendered a series of decisions in conflict with the decision of this court on the question of the right to consider a petition or motion for rehearing in banc [2314] where made by a litigant alone or by a single judge in the division which has decided the case.

It thus appears that this case is of the character described in Rule 38(5)(b) of the Supreme Court. The decisions of the Court of Appeals for the District of Columbia determining its practice there are those contained in the following communication to me from Chief Judge Stephens:

"Washington, D. C.
September 11, 1952

Honorable William Denman
Chief Judge
U. S. Court of Appeals
United States Post Office and Courthouse
San Francisco

My dear Judge Denman:

In response to your inquiry regarding the practice in this court with respect to hearings in banc and rehear-

ings in banc under the provisions of Section 46 of Title 28 of the United States Code, I wish to advise as follows:

In determining in which cases to sit in banc, two methods have been followed in the United States Court of Appeals for the District of Columbia Circuit, namely:

(1) Any judge or judges or any division of the court may request that a case be heard originally or reheard in banc. Such judge or judges or division of the court usually addresses a memorandum to all of the active circuit judges indicating why he or they thinks the case should either be heard or reheard [2315] in banc, and requests the judges to notify the chief judge of their votes on the request. If a majority favor the in banc hearing, an order to that effect is entered and the case is scheduled for the in banc hearing or rehearing.

(2) Any party to a case may by written motion or petition request that the original hearing or a rehearing to be held in banc. Such a motion or petition is submitted to and ruled upon by all of the active circuit judges of the circuit.

In the following cases rehearings in banc were ordered on the request of one member of the division of the court which originally heard the case:

No. 10446, Kephart vs. Kephart, 193 F. 2d 677.

No. 11081, Quinn vs. U. S. Not yet decided.

No. 10943, Emspak vs. U. S. Not yet decided.

In the following case rehearing in banc was ordered on the request of a judge not a member of the division which originally heard the case:

No. 10063, Stewart vs. Overholser, 186 F. 2d 339.

In the following cases the original hearings in banc were ordered on the request of the original division:

No. 11039, Thompson Co. vs. D. C. Not yet decided.

No. 11044, D. C. vs. Thompson Co. Not yet decided.

[2316] In the following case the original hearing in banc was ordered on the request of one member of the court:

No. 10473, Overholser vs. Boddie, 184 F. 2d 240.

In the following cases rehearings in banc were ordered on the petition of one of the parties:

No. 10504, in the Matter of John W. Carter, 192 F. 2d 15.

No. 10854, Columbia National Bank vs. D. C., 195 F. 2d 942.

No. 10846, Citizens Bank vs. D. C., 195 F. 2d 946.

No. 10835, D. C. vs. Catholic Education Press. Not yet decided.

Very truly yours,

/s/ HAROLD M. STEPHENS,
Chief Judge of the United States Court of Appeals for the District of Columbia Circuit."

It is ordered that the above opinion be printed as a part of the record in this case and that a properly certified copy be sent to the Supreme Court of the United States as a part of the certiorari proceedings sought by Western Pacific Railroad Corporation.

WILLIAM DENMAN,
Chief Judge

[Endorsed] Supplement to Dissenting Opinion of Chief Judge Denman. Filed Sep. 11, 1952. Paul P. O'Brien, Clerk.

Due service and receipt of a copy of the within is hereby admitted this .... day of December, 1952.

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Attorneys for petitioners The Western Pacific Railroad Corporation and Alexis I. duP. Bayard, Receiver

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Attorneys for petitioners Meredith H. Metzger, Henry Offerman and J. S. Farlee & Co., Inc.